transport services.[181] As we discuss above, lack of flexibility in our density zone pricing rules may be responsible for incumbent LECs' current failures to take full advantage of such opportunities. We conclude above that market forces are more likely to result in efficient pricing than is regulation, and, for this reason, the greater flexibility we grant here will benefit access customers through more efficient pricing of access services.

VI. PRICING FLEXIBILITY BASED ON A COMPETITIVE SHOWING

A. Background

67. The Commission has long recognized that it should allow incumbent LECs progressively greater pricing flexibility as they face increasing competition.[182] In the *Access Reform First Report and Order*, the Commission adopted a market-based approach to access charge reform, pursuant to which it would relax restrictions on incumbent LEC pricing as competition emerges, thereby ensuring that "our own regulations do not unduly interfere with the development and operation of these markets as competition develops."[183] At that time, the Commission deferred resolution of the specific timing and degree of pricing flexibility to a future Order.[184]

68. In the previous two sections, we adopt forms of regulatory relief for price cap LECs that can be granted under current market conditions and do not require a further competitive showing. Below, we consider forms of regulatory relief which, if granted prematurely, might enable price cap LECs to (1) exclude new entrants from their markets, or (2) increase rates to unreasonable levels. Accordingly, as a condition for granting further pricing flexibility, we require incumbent LECs to show that markets are sufficiently competitive both to warrant pricing flexibility to enable incumbent LECs to respond to competition and to discourage incumbents from either excluding new entrants or raising rates to unreasonable levels. In other words, we adopt requirements that price cap LECs make

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[181] MCI Oct. 26 Comments at 38-39. *See also* Time Warner Oct. 26 Comments at 14. *Contra* Ameritech Nov. 9 Reply at 9; Bell Atlantic Nov. 9 Reply at 17-18.

[182] The Commission first sought comment on a "road map" for this transition in the *Price Cap Second FNPRM,* 11 FCC Rcd 858 (1995). Later, in the *Access Reform NPRM,* the Commission noted that the parties filed pleadings in response to the *Price Cap Second FNPRM* prior to adoption of the Telecommunications Act of 1996. *Access Reform NPRM,* 11 FCC Rcd at 21428; Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 154 (1996). Accordingly, the Commission refined its pricing flexibility proposals and invited parties to submit new comments. *Access Reform NPRM,* 12 FCC Rcd at 21428-48. The Commission limited the record to pleadings filed in response to the *Access Reform NPRM,* although parties were permitted to re-submit their *Price Cap Second FNPRM* comments. *Id.* at 21428.

[183] *Access Reform First Report and Order*, 12 FCC Rcd at 16094.

[184] *Id.* at 15989.

"competitive showings," or satisfy "triggers," to demonstrate that market conditions in a particular area warrant the relief at issue.

69. The pricing flexibility framework we adopt consists of two phases. To obtain Phase I regulatory relief, the incumbent must show that competitors have made irreversible investments in the facilities needed to provide the services at issue, thus discouraging incumbent LECs from successfully pursuing exclusionary strategies. Phase I permits LECs to offer contract tariffs[185] and volume and term discounts, while requiring them to maintain their generally available price cap-constrained tariffed rates, thus protecting those customers that lack competitive alternatives. To obtain Phase II relief, which allows LECs to raise and lower rates, the incumbent must demonstrate that competitors have established a significant market presence in the provision of the services at issue. Under those market conditions, the availability of alternative providers will ensure that rates are just and reasonable. The triggers we adopt below should permit incumbent LECs to make the required showings, with a minimum of administrative burden for the industry and the Commission.

70. In Section VI.B, we define the geographic areas within which we will grant pricing flexibility. In Section VI.C.2, we establish Phase I competitive showings for (1) dedicated transport, (*i.e.*, entrance facilities, direct-trunked transport, and the dedicated component of tandem-switched transport service) and special access services other than channel terminations;[186] and (2) channel terminations.[187] In Section VI.C.3, we adopt Phase I competitive showings for common line and traffic-sensitive services, and the traffic-sensitive components of tandem-switched transport service. We specify the regulatory relief to be afforded for all these services at Phase I in Section VI.C.4, and, in Section VI.C.5, we adopt Phase II competitive showings for dedicated transport and special access services and specify the relief that is available upon satisfaction of these showings. In the Notice accompanying this Order, we seek comment on appropriate Phase II triggers for the traffic-sensitive

[185] A contract tariff is a tariff based on an individually-negotiated service contract. *See Interexchange Competition Order*, 6 FCC Rcd at 5897; 47 C.F.R. § 61.3(m). In order to comply with the nondiscrimination provisions of the Act, the Commission has required carriers to make all contract tariffs "generally available to similarly situated customers under substantially similar circumstances." *See Interexchange Competition Order*, 6 FCC Rcd at 5897. This requirement also will apply to contract tariffs offered by incumbent price cap LECs. We will require price cap LECs offering contract tariffs to include in those tariffs: (1) the term of the contract, including any renewal options; (2) a brief description of each of the services provided under the contract; (3) minimum volume commitments for each service; (4) the contract price for each service or services at the volume levels committed to by the customers; (5) a general description of any volume discounts built into the contract rate structure; and (6) a general description of other classifications, practices and regulations affecting the contract rate. *See* Section 61.55(c) of our rules, as set forth in Appendix B to this Order.

[186] *See* Section II.A.1, *supra*, for a description of these services. *See also* Section 69.709(a) of our rules, as set forth in Appendix B to this Order.

[187] *See* Section II.A.1, *supra*, for a description of channel terminations. *See also* Section 69.709(a) of our rules, as set forth in Appendix B to this Order.

components of tandem-switched transport service, and for services in the traffic-sensitive and common line baskets. In Section VI.D, we revise our price cap low-end adjustment rules with respect to those price cap LECs that qualify for and elect to exercise any of the pricing flexibilities we grant in this section. We set forth the procedural requirements governing requests for pricing flexibility in Section VI.E. We base our conclusions in this section on the record developed in response to the *Price Cap Second FNPRM* and the *Access Reform NPRM*, supplemented by pleadings filed in response to the *October 5 Public Notice* and the pending forbearance petitions.[188] Finally, in Section VI.F, we extend by ninety days the statutory deadline applicable to U S West's pending petition for forbearance from dominant carrier regulation in Phoenix, Arizona.

B. Geographic Scope of Relief

71. *Background.* In the *Price Cap Second FNPRM*, the Commission invited comment on the geographic area that it should use for purposes of reviewing requests for pricing flexibility.[189] The Commission sought to define these geographic areas narrowly enough so that the competitive conditions within each area are reasonably similar, yet broadly enough to be administratively workable.[190] Specifically, the Commission invited comment on whether individual wire centers,[191] zone density pricing zones,[192] metropolitan statistical areas (MSAs),[193] or local access and transport areas (LATAs)[194] are the most appropriate geographic areas within which to grant pricing flexibility. Later, in the *Access Reform NPRM*, the Commission solicited comment on using the geographic zones adopted by state public service

[188] The pending forbearance petitions are listed in Appendix A to this Order. Several parties recommend that we treat the forbearance petitions as *ex parte* statements in this proceeding, or consider them in the context of this proceeding. *See, e.g.*, ALTS Comments in SBC Forbearance Proceeding, CC Docket No. 98-227, at 3; NEXTLINK Opposition to Bell Atlantic Forbearance Petition, CC Docket No. 99-24, at 3.

[189] *Price Cap Second FNPRM*, 11 FCC Rcd at 911-14.

[190] *Id.* at 911-12.

[191] *Id.* at 914.

[192] *Id.*

[193] *Id.* For purposes of this Order, we use the term "MSA" to refer to MSAs as defined in Section 22.909(a) of the Commission's rules, 47 C.F.R. § 22.909(a). MSAs are listed in Common Carrier Public Mobile Services Information, Public Notice, 7 FCC Rcd 742 (1992).

[194] *Price Cap Second FNPRM*, 11 FCC Rcd at 911-14. The Commission also invited comment on using study areas for this purpose. *Id.* at 914. In the *Access Reform NPRM*, however, the Commission proposed not to rely on state-wide measures, because competitive conditions are likely to vary within a state. *Access Reform NPRM*, 11 FCC Rcd at 21423.

commissions for pricing of unbundled network elements (UNEs), or the zones adopted in the Universal Service proceeding for determining high cost areas.[195]

72. *Discussion.* We will grant pricing flexibility relief for both Phase I and Phase II on an MSA basis. We agree with those commenters that maintain that MSAs best reflect the scope of competitive entry, and therefore are a logical basis for measuring the extent of competition.[196] Because competitive LECs generally do not enter new markets on a state-wide basis, we reject proposals to define the geographic scope of pricing flexibility on the basis of states or study areas.[197] Granting pricing flexibility over such a large geographic area would increase the likelihood of exclusionary behavior by incumbent LECs by giving them flexibility in areas where competitors have not yet made irreversible investment in facilities.

73. We also decline to grant pricing flexibility on the basis of LATAs. Many LATAs include an entire state,[198] and in those cases, LATAs would be inappropriate for the same reasons we reject states and study areas as relevant markets. Of course, other states contain many LATAs, in which cases LATAs are similar to MSAs. In those cases, relying upon MSAs rather than LATAs should make little difference in determining whether to grant pricing flexibility.

74. We also reject proposals to grant pricing flexibility on the basis of wire centers or central offices.[199] CTSI and KMC suggest that competition may exist in only a small part of an MSA,[200] but we believe that the triggers we establish below are sufficient to ensure that competitors have made sufficient sunk investment within an MSA. In addition, defining geographic areas smaller than MSAs would force incumbents to file additional pricing flexibility petitions, and, although these petitions might produce a more finely-tuned picture of competitive conditions, the record does not suggest that this level of detail justifies the increased expenses and administrative burdens associated with these proposals.

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[195] *Access Reform NPRM*, 11 FCC Rcd at 21423.

[196] *See* USTA Oct. 26 Comments at 35 and Att. E; SBC Oct. 26 Comments at 18; Cincinnati Bell Oct. 26 Comments at 8 (supporting MSAs). *See also* Ameritech Oct. 26 Comments, Att. N at 2; Bell Atlantic *ex parte* statement of April 27, 1998 at 15; Ad Hoc Comments at 50-54 (supporting LATAs, which in some states are similar to MSAs).

[197] USTA Comments at 27; Sprint Comments at 39; Southwestern Bell Comments at 26.

[198] *See* Excel Nov. 9 Reply at 7.

[199] USTA Comments at 29; BellSouth Comments at 39; PacTel Comments at 26; California Commission Comments at 11; Pennsylvania ISPs Comments at 17-18. Aliant also would use wire centers for Phase II, but it prefers determining whether there is "substantial competition" on a statewide basis. Aliant Comments at 9.

[200] CTSI Nov. 9 Reply at 4-5; KMC Nov. 9 Reply at 5-6.

75. In addition, we reject proposals to permit incumbent LECs themselves to select the geographic area for which they seek pricing flexibility.[201] Determining whether the incumbent has chosen an appropriate area is likely to generate controversy, thus undermining our desire to create a framework for granting pricing flexibility, where warranted, without delay and without imposing undue burden on the industry or on Commission staff.

76. Commenters supporting MSAs have provided little if any guidance for pricing flexibility in non-MSA areas. We will grant price cap LECs pricing flexibility within the non-MSA parts of a study area[202] if they satisfy the triggers we adopt below throughout that area. We decline to mandate individual showings for each rural service area (RSA), as we do for MSAs, because we expect competitors to enter MSA markets first and then to extend their networks into less densely populated areas. Because rural areas by definition do not have large concentrations of population comparable to urban areas, we expect that competitive entry into rural areas will be less concentrated than in urban areas. Therefore, we do not expect that pricing flexibility will enable an incumbent to engage successfully in exclusionary pricing behavior with respect to one RSA because competitive entry is limited to another RSA. Because the danger of exclusionary pricing behavior is lessened, we place more weight on our goal of administrative ease, and permit incumbent LECs to file a single pricing flexibility petition for all the RSAs in a study area. In addition, price cap LECs report some service quality information on a non-MSA basis,[203] and so it should be easy for price cap LECs to collect collocation information for pricing flexibility requests in those areas.[204]

C. Phase I and Phase II Pricing Flexibility

1. General Approach

77. We will grant Phase I pricing flexibility to a price cap incumbent LEC for special access and dedicated transport services when it demonstrates either that (1) competitors unaffiliated with the incumbent LEC have established operational collocation arrangements in a certain percentage of the incumbent LEC's wire centers in an MSA, or (2) unaffiliated

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[201] BA/NYNEX Comments at 52-53; BellSouth Comments at 39; TRA Comments at 24-25; USTA Comments at 29.

[202] For cellular licensing purposes, the non-MSA part of a study area comprises one or more rural service areas (RSAs), as defined in Section 22.909(b) of the Commission's rules, 47 C.F.R. § 22.909(b). RSAs are listed with MSAs in Common Carrier Public Mobile Services Information, Public Notice, 7 FCC Rcd 742 (1992). Together, MSAs and RSAs encompass all the territory included in the incumbent LECs' study areas.

[203] *See* Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Memorandum Opinion and Order, 6 FCC Rcd 2974, 2989-90 (Com. Car. Bur. 1991).

[204] For purposes of the remainder of this section, we will use the term "MSA" to refer to the geographic areas on which price cap LECs may base pricing flexibility petitions: (1) MSAs and (2) the non-MSA parts of study areas.

competitors have established operational collocation arrangements in wire centers accounting for a certain percentage of the incumbent LEC's revenues from the services in question in that MSA.[205] In both cases, the incumbent also must show, with respect to each wire center, that at least one collocator is relying on transport facilities provided by a transport provider other than the incumbent LEC.[206] As explained above, Phase I of our pricing flexibility framework provides incumbent LECs with regulatory relief when competitors have made irreversible investments in facilities within a given MSA. At that point, we no longer need to protect competition from exclusionary pricing behavior by incumbent LECs, because efforts to exclude competitors are unlikely to succeed. In order to protect access customers that may lack competitive alternatives, we limit the extent to which Phase I flexibility permits incumbents to raise rates, because competitors that are sufficiently entrenched to survive attempts by incumbents to exclude them from the market may not yet have a sufficient market presence to constrain prices throughout the MSA.

78. For the reasons discussed below, and based on the record before us, we conclude that a collocation-based trigger for granting pricing flexibility for special access and dedicated transport reasonably balances our two goals: (1) having a clear picture of competitive conditions in the MSA, so that we can be certain that there is irreversible investment sufficient to discourage exclusionary pricing behavior; and (2) adopting an easily verifiable, bright-line test to avoid excessive administrative burdens.[207] In Section VI.C.2, we adopt specific triggers for (1) dedicated transport and special access services other than channel terminations; and (2) channel terminations. As we explain in Section VI.C.3 below, however, we adopt a different approach to granting pricing flexibility for traffic-sensitive and common line services, by requiring price cap LECs to demonstrate the extent to which competitors offer these services over their own facilities.

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[205] For purposes of our triggers, the term "wire center" shall refer to any location at which an incumbent LEC is required to provide expanded interconnection for special access pursuant to § 64.1401(a) of the Commission's rules, and any location at which an incumbent LEC is required to provide expanded interconnection for switched transport pursuant to § 64.1401(b)(1) of our rules. *See* 47 C.F.R. §§ 64.1401(a), 64.1401(b)(1). For purposes of this Order, collocation by competitors refers to collocation by carriers unaffiliated with the incumbent LEC.

[206] This requirement that at least one collocator use competitive transport facilities excludes both transport provided by the incumbent LEC pursuant to tariff and unbundled transport leased from the incumbent LEC. Henceforth in this Order, references to collocation by competitors encompass only those collocated competitors that use transport provided by a transport provider other than the incumbent LEC.

[207] *See Price Cap Second FNPRM*, 11 FCC Rcd at 908. *See also* USTA Oct. 26 Comments, Att. A at 31; Bell Atlantic Oct. 26 Comments, Exh. 1 at 11, 16. Bell Atlantic states that the history of transportation regulation, natural gas regulation, and Commission regulation of private lines in the 1960s and 1970s provides ample warning of the dangers inherent in relying upon myriad fact-finding processes to implement regulatory policy in markets in which there are multiple sellers. Bell Atlantic Oct. 26 Comments, Exh. 1 at 17.

79. *Irreversible Investment.* In the *Access Reform NPRM*, the Commission explained that the initial phase of pricing flexibility should enable incumbent LECs to "re-price access services in ways that respond to competitive pressure, but do not impede competitive entry."[208] We conclude that irreversible, or "sunk," investment in facilities used to provide competitive services is the appropriate standard for determining when pricing flexibility is warranted.[209] Phase I regulatory relief will increase the efficiency of the interstate access market and reduce prices to end-user customers; therefore, we should delay granting this relief no longer than necessary to protect the development of a competitive market. Although Phase I relief permits incumbent LECs to offer contract tariffs and expands their authority to offer volume and term discounts, it also requires LECs to maintain their existing price cap tariffed rates, thus precluding price cap LECs from abusing their market power by charging dramatically higher rates to customers that lack competitive alternatives. We are concerned, however, about the possibility that price cap LECs could use Phase I relief, which enables them to offer contract tariffs to individual customers, to engage in exclusionary pricing behavior and thereby thwart the development of competition. Economists have long noted the incentives that monopolists have to reduce prices in the short run and forgo current profits in order to prevent the entry of rivals or to drive them from the market. The monopolist then would be able to raise prices above competitive levels and earn higher profits than would have been possible if the exclusionary pricing behavior had not occurred and competitors had not exited or been deterred from entering the market.[210] Joskow and Klevorick note the conditions that increase the likelihood, and the social cost, of exclusionary pricing behavior.[211] Several of these conditions, including short-run monopoly power, low elasticity of demand, and high profits in the absence of regulatory or competitive constraints, appear to characterize the interstate access market.[212] An incumbent can forestall the entry of potential competitors by "locking up" large customers by offering them volume and term discounts at or below cost.[213] Specifically, large customers may create the inducement for potential competitors to

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[208] *Access Reform NPRM*, 11 FCC Rcd at 21429.

[209] *See* ACTA Oct. 26 Comments at 4 nn. 3, 5 (arguing that the Commission should not adopt any new pricing flexibility rules until local exchange markets are fully and "irreversibly" open to competition).

[210] *See, e.g.*, P. Areeda & D. Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975); O. Williamson, *Predatory Pricing: A Strategic an Welfare Analysis*, 87 YALE L.J. 284 (1977); J. McGee, *Predatory Pricing Revisited*, 23 J. LAW & ECON. 289 (1980); F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 468-479 (1990).

[211] P. Joskow & A. Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 YALE L.J. 213 (1979).

[212] *See* J. BONBRIGHT, PRINCIPLES OF PUBLIC UTILITY RATES 7-11 (2d ed. 1988); C.F. Phillips, THE REGULATION OF PUBLIC UTILITIES 57-58 (1993).

[213] We recognize that using volume and term discounts may be a more profitable predatory strategy than traditional predatory pricing if the predator is subject to rate regulation but can use headroom created by the discounts to raise prices in areas, or to customers, not subject to competition. In such a case, the predator may

invest in sunk facilities which, once sunk, can be used to serve adjacent smaller customers. To the extent the incumbent can lock in the larger business customers whose traffic would economically justify the construction of new facilities, the incumbent can foreclose competition for the smaller customers as well.[214] Consequently, we believe that pricing flexibility must be structured to prevent exclusionary pricing behavior so as to safeguard the development of competition.

80. An incumbent monopolist will engage in exclusionary pricing behavior only if it believes that it will succeed in driving rivals from the market or deterring their entry altogether. Otherwise, the reduced profits caused by exclusionary pricing behavior will not be recouped by other sales under the resulting conditions of reduced competition, and the incumbent will be worse off than if it had not engaged in exclusionary pricing behavior. Once multiple rivals have entered the market and cannot be driven out, rules to prevent exclusionary pricing behavior are no longer necessary. Investment in facilities, particularly those that cannot be used for another purpose, is an important indicator of such irreversible entry. If a competitive LEC has made a substantial sunk investment in equipment, that equipment remains available and capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving that competitor from the market. Another firm can buy the facilities at a price that reflects expected future earnings and, as long as it can charge a price that covers average variable cost, will be able to compete with the incumbent LEC.[215] In telecommunications, where variable costs are a small fraction of total costs,[216] the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and highly unlikely to succeed. We conclude, therefore, that our Phase I triggers should measure the extent to which competitors have made sunk investments in facilities used to compete with the incumbent LEC.

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not have to forego profits or face the usual recoupment problem.

[214] *See* E. Rasmeusen, J.M. Ramseyer, and J.S. Wiley, *Naked Exclusion*, 81 AM. ECON. REV. 1137-45 (December 1991).

[215] *See* S. MARTIN, INDUSTRIAL ECONOMICS: ECONOMIC ANALYSIS AND PUBLIC POLICY 414-15 (1998) (the likelihood of successful predation decreases to the extent of sunk investment by new entrants); *see also Incumbent LEC Regulatory Treatment Order*, 12 FCC Rcd at 15818-19 (even if a BOC interLATA affiliate could drive one of the three large IXCs from the market, that IXC's fiber-optic transmission capacity would remain intact, and another firm could buy that capacity at a distress sale and immediately undercut the affiliate's noncompetitive prices) (citing D.F. Spulber, *Deregulating Telecommunications*, 12 YALE J. ON REG. 25, 60 (1995)).

[216] B. MITCHELL AND I. VOGELSANG, TELECOMMUNICATIONS PRICING THEORY AND PRACTICE 9 (1991).

2. Phase I Triggers for Special Access and Dedicated Transport Services

a. Collocation by Competitors

81. As we explain below, collocation by competitors in incumbent LEC wire centers is a reliable indication of sunk investment by competitors. In the *Expanded Interconnection Orders*, the Commission adopted rules requiring incumbent LECs to permit competitors to collocate equipment at incumbent LEC wire centers and other LEC locations, in order to enable competitors to terminate their transmission facilities at those locations.[217] The Commission adopted these collocation rules, with only minor modifications, to implement the collocation requirements of section 251(c)(6) of the Act.[218] More recently, the Commission expanded its collocation rules to facilitate the development of competition in the advanced services market, while promoting competition in the traditional circuit-switched voice market. In particular, incumbent LECs must make available shared caged and cageless collocation arrangements, and must permit competitors to collocate all equipment used for interconnection and/or access to UNEs, even if it includes a switching or enhanced service function.[219] In many cases, a collocation arrangement indicates the existence of a competitor's transmission facilities terminating at that collocated equipment.[220] Thus collocation usually represents a financial investment by a competitor to establish facilities within a wire center. We also note that competitors incur considerable expense to establish an operational collocation arrangement. The cost to a competitor of a single collocation arrangement can exceed

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[217] *See, e.g., Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7377. *See also* Section 64.1401 of the Commission's Rules, 47 C.F.R. § 64.1401.

[218] 47 U.S.C. § 251(c)(6) (requiring incumbent LECs to provide for collocation of equipment necessary for interconnection or access to unbundled network elements); Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket Nos. 96-98, 95-185, 11 FCC Rcd 15499, 15787-89 (1996) (*Local Competition Order*), *aff'd in part and vacated in part sub nom. Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) (*CompTel*), *aff'd in part and vacated in part sub nom. Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997) (*Iowa Utils. Bd.*), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999); *Order on Reconsideration*, 11 FCC Rcd 13042 (1996); *Second Order on Reconsideration*, 11 FCC Rcd 19738 (1996); *Third Order on Reconsideration and Further Notice of Proposed Rulemaking*, 12 FCC Rcd 12460 (1997); *further recon. pending*.

[219] *See* Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147, First Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 4761 (1999), *recon. pending, petitions for review pending*.

[220] *See Special Access Expanded Interconnection Order*, 7 FCC Rcd 7369; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd 7374. Ameritech also notes that collocation is an indication that competitors have facilities in place to address dedicated transport demand. Ameritech Forbearance Petition at 16.

\$300,000.[221] Commenters also point out that negotiating all the terms of a collocation agreement can require considerable time and effort. For example, MCI states that negotiations lasted an average of six to nine months during the period from mid-1994 to mid-1996.[222] It also seems likely that, when a competitor initially enters a market, most of these transmission facilities will be "trunk-side" facilities, *i.e.*, facilities leading from the collocated equipment to the IXC POP rather than to the customer premises. This is because competitors can use those facilities to carry highly concentrated traffic between, for example, serving wire centers and POPs, and so can use that investment to serve a number of customers.[223] For the same reason, competitors will probably wait to invest in line-side facilities until they have all or most of their trunk-side facilities in place. In either case, the investment in transmission facilities associated with collocation arrangements is largely specific to a location; the competitive LEC's facilities cannot, for the most part, easily be removed and used elsewhere if entry does not succeed.

82. For all these reasons, we are confident that, in the past, the presence of an operational collocation arrangement in a wire center almost always implied that a competitor has installed transmission facilities to compete with the incumbent. This correlation between operational collocation arrangements and competitive transport facilities is somewhat attenuated, however, by the advent of services such as digital subscriber line (DSL) services. Competitors providing these services usually collocate in order to gain access to the incumbent's copper loops, a necessary input for DSL service, not to compete with the incumbent for the provision of transport services. DSL services often are marketed as broad-

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[221] *See, e.g.*, Comments of the Competitive Telecommunications Association, Implementation of the Local Competition Provisions in Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Second Further Notice of Proposed Rulemaking, FCC 99-70 (rel. April 16, 1999) (*UNE Remand FNPRM*), at 39. ACC notes that collocation charges can vary greatly from incumbent to incumbent and include numerous recurring and nonrecurring charges: from \$21,054 to \$50,055 under Colorado PUC-approved interim interconnection tariffs; from \$24,950 to \$72,139 under Pacific Bell's expanded interconnection tariff; and \$50,000 per collocation at a NYNEX wire center in Syracuse. ACC Comments at 6 and n.10. AT&T also maintains that collocation tariffs often include high nonrecurring charges (NRCs). AT&T Reply at 10-12 and n.30.

[222] MCI Comments at 38-39. *See also* AT&T Reply at 8; ACC Reply at 5. *See also* Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana, CC Docket No. 98-121, Memorandum Opinion and Order, 13 FCC Rcd 20599, 20645-46 (1998) (*Second BellSouth Louisiana Order*) (finding that BellSouth had not satisfied the section 271 requirement that incumbents provide interconnection in accordance with sections 251(c)(2) and 252(d)(1) of the Act, relying in part on evidence that it can take as long as 120 to 180 days from receipt of a complete and accurate Bona Fide Firm Order for BellSouth to construct a physical collocation space).

[223] Bell Atlantic and MCI note that competitors are particularly active in the provision of entrance facilities. Bell Atlantic *ex parte* statement of April 27, 1998, at 14; MCI Oct. 26 Comments at 55. Ameritech also relies on collocation data to demonstrate that competitors provide dedicated transport over their own facilities "where there is a significant amount of switched traffic densely aggregated." Ameritech Forbearance Petition, Att. A at 27.

based offerings to small business and residential customers, thus requiring competitors to collocate in many, if not all, of the wire centers in an MSA, many of which may lack competitive transport facilities.[224] In this case, therefore, they rely on the incumbent's transport facilities.[225] Therefore, to ensure that our triggers continue to provide a clear picture of competitive conditions on a going-forward basis, we require incumbent LECs to show that at least one competitor relies on transport facilities provided by a transport provider other than the incumbent at each wire center listed in the incumbent's pricing flexibility petition as the site of an operational collocation arrangement.

83. We acknowledge that, because we will evaluate pricing flexibility requests on an MSA basis and do not require the presence of competitive facilities in every wire center in an MSA, there remains a theoretical possibility that an incumbent LEC could use pricing flexibility in a predatory manner to deter investment in competitive facilities in those wire centers where it as yet faces no competition. For the reasons given above, however, we believe the costs, particularly the administrative costs, of granting pricing flexibility on a wire center-by-wire center basis outweigh the benefits of protecting against such theoretical harms. To the extent that an incumbent LEC attempts to use pricing flexibility in a predatory manner, aggrieved parties may pursue remedies under the antitrust laws or before this Commission pursuant to section 208 of the Act.[226]

84. *Administrative Burdens.* The Commission has tentatively concluded that it is important to base our triggers on "objectively measurable criteria . . . so as to avoid delay caused by protracted proceedings and to minimize administrative burdens."[227] We conclude here that a collocation-based trigger provides an administratively simple and readily verifiable mechanism for determining whether competitive conditions warrant the grant of pricing flexibility. In the *Price Cap Second FNPRM*, the Commission invited comment on establishing a "competitive checklist" as a test for Phase I pricing flexibility. Specifically, the

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[224] For example, Sprint states that it is in the midst of requesting collocation in more than 1000 incumbent LEC end offices so that it can install its own digital subscriber line access multiplexers (DSLAMs) and provide DSL service to small business and residential customers. Sprint Comments, *UNE Remand FNPRM*, at 35. Similarly, Covad explains that, when it builds a DSL network in a market, it collocates in "several dozen central offices" and relies on the incumbent LEC's transport services to connect those central offices to the two or three Covad "hubs" in that market. Covad Comments, *UNE Remand FNPRM*, at 44-45. *See also* Northpoint Comments, *UNE Remand FNPRM*, at 19-20.

[225] *See, e.g.*, MCI *ex parte* statement of July 7, 1999, at 8; Sprint *ex parte* statement of July 12, 1999.

[226] 47 U.S.C. § 208.

[227] *Access Reform NPRM*, 11 FCC Rcd at 21431.

Commission sought comment on eight checklist items,[228] seven of which were taken from legislation pending before Congress which led to the Telecommunications Act of 1996.[229] The 1996 Act incorporated those seven criteria into the test for determining whether a Bell Operating Company (BOC) should be permitted into the market for in-region interLATA services.[230] As a result of our review of several BOC 271 applications,[231] the Commission has found that ascertaining whether the BOC adequately has demonstrated that it is providing these checklist items on a nondiscriminatory basis is not administratively simple or easily verifiable. These applications produce voluminous records in which the parties hotly contest BOC compliance with the checklist, and resolution of these disputes within the ninety days permitted by the statute imposes considerable burdens on both industry and the Commission.

85. In order to avoid these burdensome and costly proceedings, we will rely instead on the eighth criterion -- collocation in wire centers that account for a significant portion of the incumbent LEC's business lines or interstate access revenues.[232] This approach has

[228] Those items are as follows:

a. competing providers of local switched telephone service have been authorized and become operational;
b. local loops and switches have become unbundled;
c. intrastate expanded interconnection is available through tariff or contract (physical or virtual collocation);
d. service provider number portability is available, *i.e.*, end users are able to switch local service providers and retain their current telephone numbers;
e. compensation arrangements have been established for the LEC and its competitors to complete telephone calls originated on other carriers' networks;
f. competitors have access to directory assistance, 911, and other databases;
g. intra-LATA toll dialing parity is implemented; and
h. competitors have implemented or announced plans to collocate, or otherwise deploy facilities, and serve customers in wire centers (or other geographic areas) that account for a significant portion of the incumbent LEC's business lines or interstate access revenues.

Price Cap Second FNPRM, 11 FCC Rcd at 906-07.

[229] The Commission noted that most of these criteria were contained in legislation pending at the time of the *Price Cap Second FNPRM*. *See Price Cap Second FNPRM*, 11 FCC Rcd at 906 n.159.

[230] *See* 47 U.S.C. §§ 271(c)(2)(A); 271(c)(2)(B)(ii), (iv), (vii), (x), (xi), (xiii).

[231] *See, e.g.*, *Second BellSouth Louisiana Order*; Application of Ameritech Michigan for Provision of In-Region, InterLATA Services in Michigan, CC Docket No. 97-137, Memorandum Opinion and Order, 12 FCC Rcd 20543 (1997) (*Ameritech Michigan Order*).

[232] *See Price Cap Second FNPRM*, 11 FCC Rcd at 906-07.

widespread support from diverse segments of the industry.[233] MCI argues that, if we permit any pricing flexibility at all, we should do so only upon a showing that competitors have collocated in wire centers serving a certain percentage of the incumbent LECs' demand.[234] Bell Atlantic and Ameritech also advocate granting regulatory relief when competitors have collocated in a certain percentage of wire centers in a market area,[235] or in wire centers serving a certain percentage of the demand in a market area.[236] We further conclude that such a collocation-based standard is administratively simple because several BOCs have provided data of this type in support of pending forbearance petitions.[237]

86. Finally, we have determined that it is not burdensome to require incumbent LECs to demonstrate that at least one competitor relies on transport facilities provided by a transport provider other than the incumbent at each wire center listed in the incumbent's pricing flexibility petition as the site of an operational collocation arrangement. Competitors typically must hire the incumbent to install cable from the competitors' networks to their collocated equipment.[238] Thus, incumbent LECs should be able to identify those collocators providing their own transmission facilities on the basis of their billing records. Furthermore, we do not require incumbent LECs to identify *all* the competitors collocated at each wire center and providing their own transport facilities, but rather merely to identify at least one competitor providing its own transport facilities at each wire center.

87. *Other Triggers.* We conclude that none of the other triggers proposed in this record is preferable to collocation with competitive transport. Ameritech advocates granting pricing flexibility when competitors have collocated in wire centers from which they can provide service to a certain percentage of the demand for a service in the market area, measured on the basis of DS1-equivalents.[239] MCI argues, however, that a "DS1 equivalent"

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[233] Although several commenters support the use of collocation as a trigger, they propose granting regulatory relief at different percentage thresholds. We discuss these specific proposals below.

[234] MCI Oct. 26 Comments at 55.

[235] Bell Atlantic *ex parte* statement of April 27, 1998, at 20-21.

[236] Ameritech *ex parte* statement of June 5, 1998, at 2.

[237] *See, e.g.*, Petition of Bell Atlantic Telephone Companies for Forbearance from Regulation as a Dominant Carriers in Delaware; Maryland; Massachusetts; New Hampshire; New Jersey; New York; Pennsylvania; Rhode Island; Washington, D.C.; Vermont; and Virginia, CC Docket No. 99-24, Public Notice, DA 99-224 (rel. Jan. 21, 1999); SBC Reply in SBC Forbearance Proceeding, CC Docket No. 98-227, at Att 2.

[238] *See* Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Virtual Collocation for Special Access and Switched Transport, CC Docket No. 94-97, Phase II, Order Designating Issues for Investigation, 10 FCC Rcd 11116, 11122 n.73 (1995) (brief description of cable installation services provided by incumbent LECs as part of their virtual collocation offerings).

[239] Ameritech Oct. 26 Comments, Att. N at 8; Ameritech *ex parte* statement of June 5, 1998, at 2.

measure overstates competitive inroads in a market by placing disproportionate weight on entrance facilities (which are usually DS3 circuits) where competitive entry has been greatest.[240] Because the price of one DS3 circuit is less than the price of 28 DS1 circuits,[241] even though they provide equal capacity, MCI argues that measuring competitors' market presence on the basis of revenues gives a better indication of the extent to which competitors have made significant inroads into the market in question.[242] We agree with MCI. Because competitors are drawn to new markets by the prospect of earning revenues, rather than merely opportunities to provide capacity, we find that revenue is a more relevant measure of market entry. Moreover, we want to adopt Phase I triggers that ensure that incumbent LECs can no longer successfully drive new entrants from the market. If we adopted a trigger based on percentage of demand measured in terms of DS1 equivalents, then an incumbent LEC might receive Phase I pricing flexibility for all dedicated transport services and all special access services other than channel terminations, even though competitive alternatives may exist only for entrance facilities.

88. In the *Access Reform NPRM*, the Commission sought comment on adopting triggers related to the degree to which local markets are open to competition, such as availability of UNEs at forward-looking economic cost, transport and termination at cost-based rates, and resale of retail services at a wholesale price.[243] We find that collocation-based standards provide a better basis for Phase I triggers than standards based on availability of UNEs and resale, because availability does not indicate whether they actually have been purchased. Further, a competitor's use of UNEs or resale does not indicate that it has sunk investments in facilities in the MSA, because services provided over UNEs or through resale make use of the incumbent's facilities. Purchase of UNEs by a competitor does not, by itself, constitute the type of investment in facilities that warrants pricing flexibility for special access and dedicated transport services. UNEs, by definition, comprise incumbent LEC facilities that are leased to competitors. Because competitors have few "sunk costs" associated with UNEs, if an incumbent drives a UNE-based competitor from the market, that competitor does not leave facilities in place that another firm then can buy at a discount. Instead, a subsequent competitor would have to negotiate with the incumbent for use of those UNE facilities.[244] As a result, such a competitor may be susceptible to an exclusionary pricing scheme. Similarly, the presence of a state-approved interconnection agreement or Statement of Generally

[240] MCI Oct. 26 Comments at 55.

[241] *See* AT&T Opposition to SBC Forbearance Petition, CC Docket No. 98-227, at 5; AT&T Opposition to U S West Phoenix Forbearance Petition, CC Docket No. 98-157, at 7; BellSouth Telecommunications, Inc., Tariff F.C.C. No. 1, 4th Revised Page 7-144.1 and 3rd Revised Page 7-145.0.1.2 (effective July 1, 1998).

[242] MCI Oct. 26 Comments at 55-56.

[243] *See Access Reform NPRM*, 11 FCC Rcd at 21429-32.

[244] In Section VI.C.3 of this Order, we explain why we will consider evidence of competitors' use of UNE loops as part of the required Phase I showings for other switched access services.

Available Terms and Conditions, proposed as a trigger by USTA, does not by itself indicate that new market entrants have made sufficient sunk investments in facilities to resist exclusionary pricing behavior.[245] Finally, although a transport and termination agreement between an incumbent and a competitor may imply that the competitor is carrying traffic over its own network, that may not provide evidence of investment in facilities used to compete with an incumbent LEC. For example, the competitor may carry wireless traffic, which may or may not be a competitive substitute for wireline connections, or the competitor may provide service over UNEs. Accordingly, we conclude that collocation arrangements are more likely than transport and termination agreements to demonstrate that competitors have invested in facilities sufficiently to resist exclusionary pricing behavior.

89. We also reject CFA's proposal to grant pricing flexibility only upon a showing of compliance with the section 271 criteria, among other things.[246] Section 271 compliance demonstrates that a BOC has opened its local markets to competition, but it may not show the extent of competitive alternatives in the market for interstate access services. Competition may have developed to such a degree as to warrant granting pricing flexibility to such a BOC in part of a state, even if the incumbent has not satisfied the checklist, either because it is not interested in section 271 relief, or because, for example, it is working to bring its operations support systems (OSS) into compliance. Delaying pricing flexibility under these circumstances denies access customers the benefits of increased efficiency in the interstate access market. Furthermore, we determine above not to grant pricing flexibility on a state-by-state basis because competitors generally do not enter new markets on that basis. Because section 271 requires the Commission to make state-wide determinations,[247] granting pricing flexibility upon compliance with the 14-point checklist raises the same concerns.

90. Furthermore, we will not require incumbent LECs to demonstrate that they no longer possess market power in the provision of any access services to receive pricing flexibility, for two reasons. First, as we explain in more detail below,[248] regulation imposes costs on carriers and the public, and the costs of delaying regulatory relief outweigh any costs associated with granting that relief before competitive alternatives have developed to the point that the incumbent lacks market power. Second, non-dominance showings are neither administratively simple nor easily verifiable. As several BOCs note in their forbearance petitions, the Commission previously has based non-dominance findings on several complex

[245] USTA Oct. 26 Comments, Att. E.

[246] Specifically, CFA would require "full and sustained compliance" with sections 251, 252, 253, 271, and 272 of the Act. CFA Nov. 9 Reply at 8.

[247] Section 271 requires, among other things, a BOC to satisfy the 14-point checklist throughout a state to obtain authority to offer in-region, interLATA services in that state. *See* 47 U.S.C. § 271(b)(1).

[248] *See* Section VI.C.5.a, *infra*.

criteria, including market share and supply elasticity.[249] Market share analyses require considerable time and expense, and they generate considerable controversy that is difficult to resolve. For example, in response to U S West's Phoenix forbearance petition, several commenters assert that U S West overstates its market share losses by treating re-sold services as services provided by competitors, even though U S West continues to provide the underlying facilities.[250] Sprint claims that we cannot rely on U S West's market share analysis without reviewing the underlying data.[251] Measuring supply elasticity also can be controversial; a number of commenters claim, for example, that U S West underestimates its competitors' costs of extending their networks.[252] ALTS argues, moreover, that excess capacity in competitors' networks is generally limited to particular routes, and incumbent LECs should not, therefore, rely on that existing excess capacity to support claims regarding the elasticity of supply in the interstate access market.[253]

91. We do not address in this Order whether any BOC has adequately supported its market share or supply elasticity claims in its forbearance petition. Rather, we conclude here that it would be administratively burdensome to require incumbent LECs to perform and the Commission to evaluate market share or supply elasticity analyses before the LECs may obtain any regulatory relief, and so we decline to adopt such a requirement here.

92. Finally, we disagree with commenters opposing any additional pricing flexibility for price cap LECs at this time. These commenters either argue generally that price cap LECs have sufficient pricing flexibility to respond to competition under the current price cap rules,[254] or that price cap LECs must not face meaningful competition because rates in the

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[249] *See, e.g.*, Comsat Corporation, Petition Pursuant to Section 10(c) of the Communications Act of 1934, as amended, for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier, Order and Notice of Proposed Rulemaking, 13 FCC Rcd 14083, 14118-19 (1998), *cited in* U S West Phoenix Forbearance Petition at 14; U S West Seattle Forbearance Petition at 14-32; Ameritech Forbearance Petition at 11.

[250] *See* CompTel Comments in U S West Phoenix Forbearance Proceeding at 3-4; MCI Comments in U S West Phoenix Forbearance Proceeding at 19; Sprint Comments in U S West Phoenix Forbearance Proceeding at 5-7; AT&T Comments in U S West Phoenix Forbearance Proceeding at 8; GST Comments in U S West Phoenix Forbearance Proceeding at 13-16; Qwest Comments in U S West Phoenix Forbearance Proceeding at 6.

[251] Sprint Opposition in U S West Phoenix Forbearance Proceeding at 7.

[252] *See* CompTel Comments in U S West Phoenix Forbearance Proceeding at 6-7; MCI Comments in U S West Phoenix Forbearance Proceeding at 10-13; AT&T Comments in U S West Phoenix Forbearance Proceeding at 9-10; Sprint Comments in U S West Phoenix Forbearance Proceeding at 10-11; Qwest Comments in U S West Phoenix Forbearance Proceeding at 3.

[253] ALTS *ex parte* statement of June 25, 1999, at 13.

[254] *See, e.g.*, MCI Oct. 26 Comments at 36-37.

trunking basket are generally at the maximum permitted under the price cap rules.[255] First, the existing rules clearly limit price cap LECs' ability to respond to competition. Price cap LECs are subject to both our Part 61 rules regarding rate levels and the mandatory rate structure rules set forth in Part 69 of our rules. Our rules precluding LECs from offering contract tariffs and limiting volume and term discount offerings may create a price umbrella for competitors. Second, as mentioned above, delaying regulatory relief imposes costs on carriers and the public, the latter of which is deprived of the benefits of more vigorous competition. We see no public benefit in any further delay in regulatory relief, once an incumbent LEC has satisfied the triggers we adopt below. Finally, price cap LECs were required to eliminate at least some of the headroom in the trunking basket as a result of the X-Factor increase adopted in *Price Cap Fourth Report and Order*.[256] Observing that there is no headroom in the trunking basket does not necessarily mean, therefore, that price cap LECs face no competition, because we cannot know the extent to which the X-Factor puts downward pressure on rates that the price cap LECs otherwise might have lowered in response to competition.

b. Dedicated Transport and Special Access Services, Other than Channel Terminations

93. We conclude that incumbent price cap LECs are entitled to Phase I pricing flexibility for dedicated transport services (entrance facilities, direct-trunked transport, and the flat-rated portion of tandem-switched transport) and special access services other than channel terminations upon demonstrating that competitors have collocated[257] in 15 percent of an incumbent LEC's wire centers in the MSA, or in wire centers accounting for 30 percent of the incumbent LEC's revenues from these services. The relief granted upon satisfaction of this Phase I trigger, together with the relief we grant immediately in Sections III and V above, is comparable to much of the relief proposed by Bell Atlantic and Ameritech in their 1998 *ex parte* statements.[258] We rely in part on the record developed in response to Bell Atlantic's and Ameritech's proposals in developing our Phase I triggers. Bell Atlantic proposes granting relief when competitors have collocated facilities, purchased UNEs, or installed their own

[255] *See*, *id.* at 37-38.

[256] *Price Cap Fourth Report and Order*, 12 FCC Rcd 16642.

[257] For purposes of this Order, we use the terms "collocation" and "collocated" to refer to operational collocation arrangements, *i.e.*, arrangements serving at least one customer. *See* Ameritech Forbearance Petition, Att. A at 26.

[258] We streamline the regulation of new services in Section III, and we grant greater flexibility to deaverage rates for services in the trunking basket in Section V. In addition, upon satisfying the Phase I triggers, an incumbent LEC may offer volume and term discounts and contract tariffs under the Commission's framework. Bell Atlantic and Ameritech propose all these forms of relief, plus growth discounts, X-Factor reductions, and service band index (SBI) increases. We do not permit these flexibilities in Phase I, for reasons discussed below.

facilities in 25 percent of the wire centers in the market area.[259] Ameritech recommends granting relief when competitors have collocated in wire centers serving 25 percent of the demand in a market area, measured on a DS1-equivalent basis.[260] MCI, however, recommends deferring relief until competitors account for at least 50 percent of the revenue in a market or 50 percent of the channel terminations between end offices and customer premises.[261]

94. As we explain above, we conclude that it is appropriate to give incumbent LECs pricing flexibility when competitors have made irreversible, sunk investment in facilities.[262] For the reasons discussed above, UNEs do not represent sunk investment in facilities used to compete with incumbent LECs in the provision of special access and dedicated transport services, and so we reject Bell Atlantic's proposal that we include purchase of UNEs as a measure of competitive presence within a wire center. We also reject Bell Atlantic's proposal that we grant flexibility when competitors have collocated facilities *or* installed their own facilities in 25 percent of the wire centers in the market area.[263] Although the presence of competitive facilities within a wire center may well be the best evidence of irreversible investment, this type of trigger is neither simple to administer nor easily verifiable. Our review of the records developed in response to the pending forbearance petitions indicates widespread disagreement among the parties as to the scope and reach of competitive facilities within a particular geographic area.[264] A competitor has "installed its own facilities" within a wire center if, for example, it has laid fiber anywhere within the area served by the wire center, but a separate analysis is required to determine what proportion of the incumbent's customers the competitor can serve with those facilities. Our desire to avoid these administratively burdensome proceedings compels us to adopt collocation as a measure of competitive presence.

95. We recognize, however, that evidence of collocation may underestimate the extent of competitive facilities within a wire center, because it fails to account for the presence of competitors that do not use collocation and have wholly bypassed incumbent LEC facilities.

[259] Bell Atlantic *ex parte* statement of April 27, 1998, at 20.

[260] Ameritech *ex parte* statement of June 5, 1998, at 2.

[261] MCI Oct. 26 Comments at 55.

[262] Our conclusions concerning whether an incumbent LEC is entitled to pricing flexibility in no way prejudge either the Commission's approach to or the outcome of the pending proceeding pertaining to the obligations of incumbent LECs to provide unbundled network elements. *See UNE Remand FNPRM.*

[263] Bell Atlantic *ex parte* statement of April 27, 1998, at 20.

[264] *See, e.g.*, U S West Phoenix Forbearance Petition in CC Docket No. 98-157, at 12-14; MCI Opposition in U S West Phoenix Forbearance Proceeding, CC Docket No. 98-157, at 8 (dispute over reach of competitive facilities in Phoenix MSA).

For this reason, and because the Phase I relief we are granting is not as extensive as that sought by the incumbent LECs,[265] we find that a threshold lower than 25 percent is warranted. Based on the information submitted in support of several pending petitions for forbearance,[266] it appears that collocation in 15 percent of an incumbent's wire centers in an MSA represents significant investment in competitors' facilities. For example, Bell Atlantic reports that competitors have collocated in 17.9 percent of its wire centers in the Norfolk LATA,[267] and that competitors have installed about 2200 miles of fiber in that LATA.[268] In three SBC MSAs in which competitors have collocated in slightly more than 15 percent of SBC's wire centers,[269] SBC reports that competitors' networks average at least 736 miles.[270] This figure seems conservative because SBC reports figures for only a few of its competitors within these

[265] We explain below that we reject proposals to permit growth discounts or X-Factor reductions as forms of regulatory relief. In addition, Bell Atlantic advocates permitting incumbent LECs limited upward pricing flexibility. Bell Atlantic *ex parte* statement of April 27, 1998, at 22. We do not permit any upward pricing flexibility in Phase I.

[266] For the purposes of this rulemaking, we need not determine whether the studies submitted in support of the pending forbearance petitions justify the relief sought in those proceedings. The firm conducting those studies, Quality Strategies, Inc., bases its conclusions on surveys of telecommunications customers in an MSA. *See, e.g.*, SBC Forbearance Petition, Att. A at 45-46. Several commenters criticize the Quality Strategies studies as providing inadequate support for the BOCs' claims of market share loss. *See, e.g.*, Hyperion Opposition to SBC Forbearance Petition, CC Docket No. 98-27, at 4-6; KMC Opposition to SBC Forbearance Petition, CC Docket No. 98-27, at 2-4; Logix Opposition to SBC Forbearance Petition, CC Docket No. 98-27, at 3-6. Only AT&T questions Quality Strategies's data on the extent of competitors' investment, however. AT&T Opposition to SBC Forbearance Petition, CC Docket No. 98-27, at 8 n.10. In reply, SBC maintains that AT&T did not provide sufficient detail for its claims regarding the extent of competitors' investment but theorizes that the difference between the AT&T and Quality Strategies data results from differences in the size of the areas analyzed. For example, SBC claims that AT&T probably focuses on downtown Los Angeles, while Quality Strategies examined the entire Los Angeles area. SBC Reply in SBC Forbearance Proceeding, CC Docket No. 98-227, Att. 1 at 9. SBC is persuasive on this point. Therefore, without reaching the issue of whether we can base market share determinations on the Quality Strategies studies, we find that we can rely on those studies to supplement the record in this proceeding regarding where competitors have collocated or installed facilities in certain MSAs.

[267] Bell Atlantic Forbearance Petition, Att. C at 25.

[268] *Id.*, Exh. 10 at 2.

[269] Those MSAs are Sacramento (8 wire centers; 21 percent); Houston (11 wire centers; 18 percent); and San Antonio (6 wire centers; 21 percent). SBC Reply in SBC Forbearance Proceeding, CC Docket No. 98-227, Att. 2.

[270] Competitors have installed at least 400 route miles of fiber in Sacramento, at least 1228 route miles in Houston, and at least 580 miles in San Antonio. SBC Forbearance Petition, Att. A at 14, 38, 41.

MSAs.[271] Because a competitor must devote significant time and expense to establish each collocation arrangement,[272] the extent of collocation in those three SBC MSAs indicates that competitors have made considerable investment in these MSAs. We conclude, therefore, that collocation by competitors in 15 percent of the incumbent LEC's wire centers in an MSA is the appropriate trigger for Phase I relief with respect to dedicated transport services and special access services other than channel terminations.

96. Our selection of this 15 percent threshold and the other thresholds we adopt below, like ratemaking issues, is not an exact science.[273] Rather, the thresholds are policy determinations based on our agency expertise, our interpretation of the record before us in this proceeding,[274] and our desire to provide a bright-line rule to guide the industry. This latter factor counsels against adoption of triggers that may provide more comprehensive measures of competition but impose heavy burdens on both industry and the Commission. Our effort to select triggers that precisely measure competition for particular services also is hampered by the lack of verifiable data concerning competitors' revenues and facilities. Unlike incumbent LECs, competitors are not subject to Commission reporting requirements, and they often are unwilling to provide this information voluntarily. Given these constraints, we adopt triggers that, in our reasoned judgment, balance both the desires for precision and simplicity and the costs to carriers and customers alike of delaying the grant of pricing flexibility.

97. In some cases, a few wire centers may account for a disproportionate share of revenues for a particular service. For instance, Bell Atlantic claims that 93 percent of its special access demand measured on a DS-1 equivalent basis is concentrated in 20 percent of its wire centers.[275] Although, as we explained above, measuring demand on a DS-1 equivalent basis overstates competitors' presence, we nevertheless find that Bell Atlantic has shown that demand is often concentrated in particular areas. We find that collocation in wire centers representing a significant percentage of incumbent LEC revenues from a particular service also indicates meaningful investment by competitors. Accordingly, we will permit

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[271] SBC provides route mileage data for only two of its three competitors in Sacramento, and only two of its four competitors in San Antonio. In Houston, SBC claims that TCG's network is comprised of 600 to 800 route miles. SBC Forbearance Petition, Att. A at 14, 38, 41.

[272] *See* Section VI.C.2.a. *supra*.

[273] *See* United States v. FCC, 707 F.2d 610, 618 (D.C. Cir. 1983) (*United States v. FCC*) (citing Association of American Publishers, Inc., v. Governors of the United States Postal Service, 485 F.2d 768, 773 (D.C. Cir. 1973)).

[274] *United States v. FCC*, 707 F.2d at 618 (citing Permian Basis Area Rate Cases, 390 U.S. 747, 790 (1968); Sun Oil Co. v. FPC, 445 F.2d 764, 767 (D.C. Cir. 1971)).

[275] Bell Atlantic Forbearance Petition, Att. A at 2.

price cap LECs to satisfy the Phase I trigger on a revenue basis, as well as by showing that competitors have collocated in a percentage of incumbent LEC wire centers in an MSA.

98. We conclude that the revenue-based trigger should be higher than the trigger based on percentage of wire centers in the MSA in which competitors have collocated. If certain wire centers account for a disproportionate share of revenues, then we need to establish revenue-based thresholds higher than the percentage-based threshold to ensure that competitors have extended their networks beyond a few revenue-intensive wire centers. Ameritech recommends granting relief if competitors have collocated in wire centers providing service to 25 percent of the demand for transport services measured on the basis of DS1-equivalents.[276] MCI advocates conditioning relief on competitors achieving a 50 percent market share in revenue terms.[277] Based on these pleadings, we conclude that incumbents will qualify for Phase I relief upon demonstrating that competitors have collocated in wire centers accounting for 30 percent of the incumbent's revenues for special access (other than channel terminations) and dedicated transport services.

99. Bell Atlantic asserts that a revenue-based trigger is unworkable because the proper allocation of revenues among offices for a special access or dedicated transport services routed through multiple offices might be open to dispute.[278] Bell Atlantic's argument is unpersuasive with respect to channel terminations because those services are not routed through intermediate offices. With respect to other special access and dedicated transport services, however, we agree that there is a revenue allocation issue. Access customers order special access and dedicated transport services to provide a transmission path between two customer-designated locations.[279] We therefore direct any LEC seeking pricing flexibility to allocate 50 percent of the revenue from a dedicated service routed through multiple offices to the office at each end of the transmission path, unless it can make a convincing case in its petition that some other allocation would better represent the extent of competitive entry in the MSA at issue. Although a 50 percent allocation rule seems reasonable, we cannot conclude that other allocation schemes might not also be reasonable under the circumstances. Although this is not a bright-line test like we have adopted elsewhere in this Order, determining whether a petitioner has made a convincing showing on this allocation issue should not be difficult.

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[276] Ameritech *ex parte* statement of June 5, 1998, at 2.

[277] MCI Oct. 26 Comments at 55.

[278] Bell Atlantic *ex parte* statement of May 27, 1999, at 8-9.

[279] *See, e.g.*, Investigation of Special Access Tariffs of Local Exchange Carriers, CC Docket No. 85-166, Phase I, Tentative Decision, 8 FCC Rcd 1059, 1063-64 (1993); Investigation of Special Access Tariffs of Local Exchange Carriers, CC Docket No. 85-166, Phase I, Memorandum Opinion and Order, Tentative Decision, 12 FCC Rcd 7026, 7042 (1997).

c. Channel Terminations

100. We conclude that pricing flexibility for channel terminations requires separate consideration of the degree of competition for channel terminations between an IXC POP and LEC serving wire center and channel terminations between a LEC end office and customer premises. Accordingly, incumbent LECs qualify for Phase I pricing flexibility with respect to channel terminations between an IXC POP and a LEC serving wire center by showing that competitors have collocated in 15 percent of the wire centers in an MSA, or in wire centers accounting for 30 percent of incumbent LEC revenues from these services. With respect to channel terminations between a LEC end office and a customer premises, incumbent LECs qualify for Phase I pricing flexibility by showing that competitors have collocated in 50 percent of incumbent LEC wire centers in the MSA, or in wire centers accounting for 65 percent of incumbent LEC revenues from these services.[280]

101. We find that channel terminations between a LEC end office and a customer premises warrant different treatment than other special access and dedicated transport services.[281] ALTS recommends treating channel terminations separately from other special access and dedicated transport services because channel terminations are not substitutes for those services.[282] MCI recommends granting relief in the transport market only upon a showing that competitors have captured a 50 percent market share in revenue terms, or 50 percent of the channel terminations between end offices and customer premises.[283]

102. We agree that pricing flexibility for channel terminations between a LEC end office and a customer premises requires a higher threshold than flexibility for other dedicated

[280] The triggers we adopt here for granting pricing flexibility for particular services do not vary according to the technology employed. For example, the Commission found that certain digital subscriber line (DSL) services offered by incumbent LECs are special access services. *See* GTE Telephone Operating Cos. GTOC Transmittal No. 1148, CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466, 22480 (1998); Bell Atlantic Telephone Cos., *et al.*, CC Docket Nos. 98-168, 98-161, 98-167, 98-103, Memorandum Opinion and Order, 13 FCC Rcd 23667, 23675 (1998). Accordingly, we will grant LECs pricing flexibility for the provision of these services upon satisfaction of the Phase I or Phase II criteria for channel terminations between an end office and a customer's premises.

[281] *See* MCI Oct. 26 Comments at 57 (noting that, if a CLEC does not build to all locations using its own facilities, it must collocate in incumbent LEC wire centers and rely on incumbent LEC facilities for the path between the end office and the customer premises).

[282] ALTS *ex parte* statement of June 25, 1999, at 10.

[283] MCI Oct. 26 Comments at 55. Upon this showing, MCI would permit incumbent LECs to offer contract tariff services. MCI Oct. 26 Comments at 48. MCI opposes any intermediate regulatory relief, arguing that our current rules afford incumbent LECs adequate pricing flexibility and that no more flexibility is warranted until incumbents can show that they face "substantial competition." MCI Oct. 26 Comments at 57-59. At most, MCI would permit incumbent LECs to increase their zone density pricing zones from three to five. MCI Oct. 26 Comments at 58-59.

transport and special access services. Entrance facilities, direct-trunked transport, channel mileage, and the flat-rated portion of tandem-switched transport all involve carrying traffic from one point of traffic concentration to another. Thus, entering the market for these services requires less investment per unit of traffic than is required, for example, for channel terminations between an end office and customer premises. Furthermore, investment in entrance facilities enables competitors to provide service to several end users, while channel terminations between an end office and customer premises serve only a single end user. Accordingly, competitors are likely to enter the market for entrance facilities, direct-trunked transport, channel mileage, and the flat-rated portion of tandem-switched transport before they enter the market for channel terminations between a LEC end office and a customer premises.[284] We therefore adopt a higher threshold for granting flexibility for these channel terminations than for other special access and dedicated transport services.

103. This higher threshold is warranted for another reason. As a number of parties indicate, a competitor collocating in a LEC end office continues to rely on the LEC's facilities for the channel termination between the end office and the customer premises, at least initially, and thus is susceptible to exclusionary pricing behavior by the LEC,[285] and so collocation by competitors does not provide direct evidence of sunk investment by competitors in channel terminations between the end office and the customer premises. We recognize, therefore, the shortcomings of collocation as a measure of competition for channel terminations between end offices and customer premises, but it appears to be the best option available to us at this time. MCI's suggestion that LECs show that competitors have captured 50 percent of the market for these services[286] is problematic because market share determinations are unreliable in the absence of verifiable data regarding competitors' revenues. The Commission has, to date, engaged only in voluntary data collection with respect to competitive providers of telecommunications services, and those efforts are not satisfactory for providing a comprehensive picture of the degree of competition in the marketplace. AT&T's most recent proposal to measure competition for channel terminations by comparing revenue represented by competitive facilities to revenue represented by incumbent LEC facilities suffers from the same deficiency.[287] AT&T acknowledges that data used to support the revenue measure is not now available, either to the Commission or to the incumbents that would be required to satisfy any such trigger; it states that the data "would be developed by and drawn from the industry as necessary, subject to appropriate certification and verification

[284] *See* MCI Oct. 26 Comments at 55; Bell Atlantic *ex parte* statement of April 27, 1998, at 14; Ameritech Forbearance Petition, Att. A at 26-26 and exh. 2.

[285] *See* MCI Oct. 26 Comments at 64 (If a competitor relies on collocation, it cannot provide an alternative to incumbent's channel terminations between the central office and the customer premises unless the incumbent offers unbundled loops at cost-based rates).

[286] MCI Oct. 26 Comments at 55.

[287] *See* AT&T *ex parte* statement of July 29, 1999, at 2.

procedures."[288] Although we welcome suggestions from AT&T and others about the desirability of formal reporting requirements, we are not prepared to defer pricing flexibility to seek comment on those proposals.[289]

104. Despite the shortcomings of using collocation to measure competition for channel terminations, moreover, it seems likely that a new market entrant would provide channel terminations through collocation and leased LEC facilities only on a transitional basis and will eventually extend its own facilities to reach its customers. It also seems likely, therefore, that the extent to which competitors have collocation arrangements in an MSA is probative of the degree of sunk investment by competitors in channel terminations between the end office and the customer premises throughout the MSA. In addition, as we discuss above, collocation is a conservative measure of competition in that it does not measure competition from competitors that bypass LEC facilities altogether. Given the lack of other data in the record, therefore, we conclude that it is reasonable to rely on collocation as a proxy for irreversible, sunk investment in channel terminations between the end office and the customer premises and to set the applicable thresholds high enough to account for the limitations inherent in this trigger. Based on this reasoning, we reach two conclusions: (1) we must require incumbent LECs to make separate showings for each kind of channel termination; and (2) the thresholds for channel terminations between the end office and the customer premises must be higher than the thresholds for channel terminations between the IXC POP and the serving wire center.

105. Thus, we reject incumbent LEC recommendations to the extent that they advocate adoption of the same triggers for all channel terminations as for other dedicated transport and special access services. Instead, we adopt a trigger for channel terminations between a LEC end office and a customer premises based in part on MCI's recommendation that incumbent LECs must demonstrate that competitors have gained a 50 percent market share in revenue terms, or 50 percent of the channel terminations between end offices and customer premises. In order to avoid administratively burdensome market share determinations, however, we adopt collocation rather than market share as a measure of competitive presence. Specifically, we will permit Phase I pricing flexibility for channel terminations between an incumbent LEC's end office and customer premises when competitors have collocated in 50 percent of incumbent LEC wire centers in the MSA. Bell Atlantic reports that competitors have collocated in 50 percent of its wire centers in two LATAs, New York Metro and Philadelphia.[290] Furthermore, Bell Atlantic states that its

[288] AT&T *ex parte* statement of July 29, 1999, at 1.

[289] AT&T's latest proposal that the Commission collect revenue data from competitors is not reflected in the comments it submitted in response to the December 1996 *Access Reform NPRM* or in response to the *October 5 Public Notice.*

[290] Bell Atlantic Forbearance Petition, Att. C at 25.

competitors in Philadelphia include AT&T, with a 300-mile network,[291] and MCI, with a 100-mile network.[292] Bell Atlantic also lists five other competitors providing service in Philadelphia.[293] It seems likely that some of that investment is in channel terminations, suggesting that collocation in 50 percent of the wire centers in a geographic area correlates to sunk investment in channel terminations. Accordingly, we conclude that collocation in 50 percent of an incumbent LEC's wire centers within an MSA is an appropriate threshold for channel terminations between that LEC's end office and customer premises.

106. As we found above with respect to dedicated transport and other special access services, demand for these channel terminations may be fairly concentrated. Therefore, we also permit incumbent LECs to demonstrate that competitors have collocated in wire centers accounting for 65 percent of incumbent LEC revenues from these services. This 65 percent threshold is 15 percent higher than the trigger based on percentage of the wire centers in an MSA where competitors have collocated. This 15 percent difference is consistent with the difference in the triggers we adopted for dedicated transport and other special access services, *i.e.*, wire centers accounting for 30 percent of the incumbent LEC's revenues for those services, or collocation at 15 percent of the wire centers in the MSA.

107. We also find, however, that a lower threshold is warranted for channel terminations between a LEC serving wire center and an IXC POP. As explained above, competition is likely to develop first for those services that carry traffic between points of high traffic concentration. Moreover, a competitor collocated at a LEC serving wire center provides the channel termination to an IXC POP over its *own* facilities.[294] We conclude that incumbent LECs may demonstrate sunk investment by competitors with respect to these channel terminations if competitors have collocated in 15 percent of the wire centers in an MSA, or in wire centers accounting for 30 percent of the demand, measured by revenues, for these channel terminations in the MSA. Because these channel terminations carry traffic between points of concentration similar to the points connected by entrance facilities, we conclude that they should have the same trigger.

3. Phase I Triggers for Other Switched Access Services

108. We conclude that an incumbent price cap LEC should be allowed Phase I pricing flexibility for common line and traffic-sensitive services, and the traffic-sensitive

[291] *Id.*, Exh. 7 at 2.

[292] *Id.*, Exh. 7 at 1.

[293] Those competitors are Hyperion, Intermedia Communications, Inc., NEXTLINK, Metromedia Fiber Network, Inc., and Winstar Communications, Inc. *Id.*, Exh. 7 at 4-6.

[294] As we explained above, a competitor collocated at a LEC end office generally leases *LEC* facilities to reach end user customers.

components of tandem-switched transport service, when it demonstrates that competitors, in aggregate, offer service over their own facilities to at least 15 percent of incumbent LEC customer locations in the MSA.[295]

109. We conclude above that Phase I relief for a particular service is warranted when an incumbent LEC demonstrates that competitors have made irreversible investment in facilities used to compete with the incumbent LEC in the provision of that service. For special access and dedicated transport services, we adopt a trigger based on collocation by competitors because competitors historically have collocated in incumbent LEC wire centers in order to provide transport and special access services.[296] Thus collocation furnishes evidence of irreversible investment in facilities in part because it indicates competitive transmission facilities terminating at the collocation site.[297] Although we acknowledge that some competitors provide these services exclusively over their own facilities (total facilities bypass), the extent of such competition is difficult to measure. Because collocation traditionally has served as the building block for competitive transport services, we conclude that it constitutes a sufficient measure of the degree to which competitors have invested in facilities to provide these services.

110. Competition for common line and traffic-sensitive services, however, is a much more recent phenomenon, and it may not develop in this same manner. For this reason, a different approach to granting pricing flexibility for these services is warranted. For traffic-sensitive and common line services, we adopt a Phase I trigger that takes into account competitors that have wholly bypassed incumbent LEC facilities, as well as competitors that collocate in incumbents' wire centers so as to provide service over unbundled loops.

111. The 1996 Act opened the local exchange market and, hence, the market for switched access services, to competition.[298] The Act envisions three alternatives that competitors might employ, either singly or in combination, to enter this market: total service resale, service using unbundled network elements, and service provided over the competitor's

[295] Tandem-switched transport has three components: a per-minute charge for transport of traffic over common transport facilities between the incumbent LEC's end office and the tandem switching office; a per-minute tandem switching charge; and a flat-rated charge for transport of traffic over dedicated transport facilities between the serving wire center and the tandem switching office. 47 C.F.R. § 69.111(a)(2). For the purposes of this section, we include traffic-sensitive components of tandem-switched transport service in the term "traffic-sensitive service." We address Phase I pricing flexibility for the dedicated component of tandem-switched transport, *supra*, in Section VI.C.2.b.

[296] *See* Section VI.C.2, *supra*.

[297] *See* Section VI.C.2.a, *supra*.

[298] *See, e.g.*, *Access Reform NPRM*, 11 FCC Rcd at 21358-59.

own facilities.[299] Not all of these entry strategies, however, indicate that competitors have made irreversible investment in facilities used to compete with incumbents in the provision of switched access services. As we explain above,[300] resold services employ only incumbent LEC facilities and thus do not indicate any irreversible investment by competitors whatsoever. Similarly, a competitor providing service solely over unbundled network elements leased from the incumbent (the so-called "UNE platform"[301]) has little, if any, sunk investment in facilities used to compete with the incumbent LEC.[302] For these reasons we do not allow an incumbent LEC to qualify for Phase I relief as a result of competition solely from resale or unbundled network elements.

112. If, however, competitors offer switched access services either entirely over their own facilities or by combining unbundled loops with their own switching and transport, this indicates the type of irreversible investment in facilities that warrants Phase I pricing flexibility for these services. In the first case, the competitor bypasses incumbent facilities altogether; in the latter case, a competitor must collocate in an incumbent's wire center to connect the leased loops to its transport facilities. Although a trigger based solely on collocation is administratively simpler and more easily verified, we decline in this case to adopt such a trigger because we lack sufficient experience with competition in the local exchange and switched access markets to know the extent to which competitors might rely on either of these entry strategies. We note, for example, that the time and expense required to establish collocation arrangements[303] and the difficulties associated provisioning of UNEs by incumbent LECs[304] may encourage competition through total bypass. Because it is unclear, therefore, the extent to which competitors are pursuing UNE-based entry strategies,[305] we conclude that data concerning total bypass may be particularly important in assessing the degree of competitive entry in the markets for switched services.

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[299] *See, e.g.*, *Local Competition Order*, 11 FCC Rcd at 15509.

[300] *See* Section VI.C.2.a, *supra*.

[301] *See Ameritech Michigan Order*, 12 FCC Rcd at 20628.

[302] *See* Section VI.C.2.a, *supra*.

[303] *See id.* *See also* Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147, First Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 4761, 4771-93 (1999).

[304] *See, e.g.*, *Second BellSouth Louisiana Order*, 13 FCC Rcd at 20652-706.

[305] INDUSTRY ANALYSIS DIVISION, COMMON CARRIER BUREAU, FCC, LOCAL COMPETITION, at Tables 3.4, 3.5 (1998) (Table 3.4 presents lines provided by large incumbent LECs to CLECs for resale, Table 3.5 presents lines provided by large incumbent LECs to CLECs as UNE loops).

113. Rather than looking solely at collocation, therefore, we adopt a Phase I trigger for switched services that measures the extent to which competitors offer these services either exclusively or largely over their own facilities. We will grant Phase I pricing flexibility for common line and traffic-sensitive services to an incumbent LEC in an MSA if that LEC demonstrates that competitors offer service over their own facilities to 15 percent of the incumbent's customer locations in the MSA. As we explain above, a competitor provides service over its own facilities if it leases unbundled loops but provides its own switching and transport. A competitor is not, however, offering service over its own facilities to the extent it offers service through resale or exclusively through the use of unbundled network elements. We acknowledge that we have concluded, both for determining eligibility for universal service support under section 254(e) of the Act and for BOC applications under section 271 to provide in-region interLATA services, that a carrier's "own" facilities include UNEs provided by the incumbent LEC.[306] For purposes of this Order, however, we use "own facilities" in a narrower sense, excluding UNEs provided by the incumbent LEC, except in the case of CLECs using unbundled loops in conjunction with their own switching and transport facilities.

114. We also decline at this time to permit incumbents to satisfy the Phase I trigger by showing that customer locations are served by mobile wireless competitors. Although Congress allowed the Commission to consider competition from Personal Communications Service (PCS) in the context of Bell Operating Company (BOC) applications for in-region interLATA authority when PCS serves as a substitute for the BOC's services,[307] inclusion and evaluation of such data is problematic for purposes of determining whether an incumbent LEC is entitled to Phase I pricing flexibility, primarily because it is difficult to assess whether mobile (as opposed to fixed) wireless serves as a substitute for (and thus competes with) wireline service provided by an incumbent LEC.[308]

115. In arriving at the 15 percent trigger, we note that the relief granted upon satisfaction of the Phase I trigger for common line and traffic-sensitive services, together with the relief we grant immediately in Sections III and V above, is comparable to much of the

[306] *See* Federal-State Joint Board on Universal Service, Report and Order, 12 FCC Rcd 8776, 8862 (1997) (*Universal Service Order*); *Ameritech Michigan Order*, 12 FCC Rcd at 20598.

[307] *See* 47 U.S.C. § 271(c)(1)(A); *Second BellSouth Louisiana Order*, 13 FCC Rcd at 20621-25.

[308] *Second BellSouth Louisiana Order*, 13 FCC Rcd at 20625-30.

switched services relief proposed in *ex parte* submissions by Bell Atlantic,[309] Ameritech,[310] and USTA.[311]

116. Bell Atlantic recommends granting relief when competitors have "demonstrated the capability" to provide service in wire centers representing, in aggregate, at least 25 percent of the demand for the service in question, *i.e.*, residential/single-line-business and multi-line business.[312] Under Bell Atlantic's proposal, competitors have demonstrated the ability to provide service in a wire center if they provided service with their own or ported telephone numbers to any of the relevant class of customers.[313] Ameritech proposes granting relief when competitors have collocated in wire centers serving 25 percent of the demand in a market area, measured on an interstate minutes-of-use basis.[314] USTA also proposes a 25 percent threshold, but bases it on the sum of line demand attributable to (1) wire centers in which there is operational collocation *and* competitors are taking unbundled loop or

[309] Bell Atlantic *ex parte* statement of April 27, 1998. Bell Atlantic proposes that, upon a showing that 25 percent of wire centers are "competitive" (based on the existence of any competitor-served telephone number in the wire center), we allow incumbent LECs to deaverage common line and local switching charges; offer volume and term pricing with growth options; offer promotions; and seek approval on an expedited basis to respond to requests for proposals (RFPs). *Id.* at 27. (Bell Atlantic proposes that we grant incumbent LECs some of this relief, such as geographic deaveraging, on a lesser showing).

[310] Ameritech *ex parte* statement of June 5, 1998, at 2. Ameritech proposes that, upon a showing that competitors have collocated in incumbent LEC wire centers accounting for 25 percent of interstate local switching minutes-of-use, we allow incumbent LECs to deaverage common line and local switching charges; offer bundled service packaging, contracts, and volume and term pricing (with growth options); and provide new services on a relaxed basis. *Id.* at 2. (Ameritech proposes that we grant incumbent LECs some of this relief, such as geographic deaveraging, on a lesser showing).

[311] USTA *ex parte* statement of June 1, 1999. USTA proposes that, upon a showing that 25 percent of total lines in a market have "access to" alternative facility-based local services (*i.e.*, all lines served by a wire center with operational collocation and lines located within a 1000 feet of another provider's facility), we allow incumbent LECs to deaverage subscriber line charges (SLCs) and local switching charges; offer volume and term pricing; offer contracts and promotions; and seek approval on an expedited basis to respond to RFPs. *Id.* at 1. (USTA proposes that we grant incumbent LECs some of this relief, such as geographic deaveraging, on a lesser showing).

[312] Bell Atlantic *ex parte* statement of April 27, 1998, at 27.

[313] *Id.* Bell Atlantic proposes that a wire center also be classified as "competitive" if competitors use collocation and UNEs to provide service in the wire center. *Id.* Because UNE customers would be served through CLEC-ported or "owned" telephone numbers, this test appears to be merely a subset of the telephone number test.

[314] Ameritech *ex parte* statement of June 5, 1998, at 2.

unbundled local switching UNEs and (2) lines located within 1000 feet of competitive facilities.[315]

117. For the reasons we discuss above, we find that a competitor has not made irreversible investment in facilities to provide common line and/or traffic-sensitive services unless it does so through its own facilities. We therefore reject the triggers proposed by the incumbent LECs and USTA to the extent they can be satisfied by UNE platform and resale competition.[316] Given, however, that we require evidence that competitors offer service over their own facilities, and that we do not grant relief as extensive as that sought by the incumbent LECs, we adopt a trigger lower than the 25 percent threshold they propose. We will therefore grant an incumbent LEC Phase I relief for common line and traffic-sensitive services when it demonstrates that competitors, in aggregate, offer service over their own facilities to at least 15 percent of incumbent LEC customer locations in the MSA. Because competitive provision of both local switching and traffic-sensitive components of tandem switched transport service are dependent on switch ownership, we conclude that Phase I relief for these services should be tied directly to the Phase I relief for common line services.

118. We reject Bell Atlantic and USTA's proposals that we allow incumbent LECs to qualify for pricing flexibility by class-of-service, *e.g.*, for residential/single-line-business and multi-line business service,[317] because we wish to encourage competition for both high-volume business customers and residential and low-volume business customers.

119. We acknowledge that demonstrating the degree to which competitors are providing service over their own facilities is more administratively burdensome than merely measuring the extent to which competitors have collocated in incumbent LEC wire centers.[318] As discussed above, however, total bypass may represent a significant portion of competition for switched access services,[319] thus we will not rely solely on collocation as a measure of

[315] USTA *ex parte* statement of June 1, 1999, at 2.

[316] Customers served via resale or the UNE platform may represent significant numbers of "owned" or "ported" telephone numbers. Similarly, evidence of competitors using unbundled local switching UNEs does not, by itself, indicate competitors' investment in facilities.

[317] Like Bell Atlantic, USTA proposes that incumbent LECs may target showings to, and therefore request relief for, residential/single-line-business or multi-line business services. USTA *ex parte* statement of June 1, 1999. USTA notes that when an incumbent LEC makes a separate showing for residential/single-line-business services, it may be appropriate to use a total bypass threshold less than 1000 feet. *Id.*

[318] *See* Section VI.C.2.a, *supra*.

[319] In establishing our Phase I trigger for dedicated transport and special access services, based on our experience observing the development of the market for these services, we find it reasonable to use collocation as a proxy for all forms of competition in the market for such services. As discussed, *supra*, however, we do not have such a history to evaluate in the switched access market and therefore are not as able to predict the

competition for these services. We therefore conclude that any increased administrative burdens in measuring total facilities bypass competition are in the public interest.

120. We emphasize that incumbent LECs must demonstrate that competitors actually offer, not merely are capable of offering, common line and traffic-sensitive services to 15 percent of an incumbent LEC's customer locations within an MSA to qualify for Phase I relief. On the other hand, we are not requiring that competitors actually provide service to a specific percentage of customers. "Offering service" is an appropriate measure of competitive entry for these services because of the difficulties inherent in determining the extent to which competitors actually provide service to current or former customers of the incumbent. This constitutes sensitive competitive information that the incumbent may be unable, and a competitor unwilling, to provide. Moreover, we see no need to require this information. In contrast to special access or even dedicated transport services, competitors are likely to employ more broadly based entry strategies for common line and traffic-sensitive services. Once a competitor installs a switch in its network, it has every incentive to maximize the number of customers it serves with that switch, in order to spread the sunk switch investment over the broadest base possible. In addition, special access services may have diminished the demand among high volume users for competitive switched services, because high volume customers use special access as an alternative to switched access, an option that is not available to low volume users of switched services. Thus switched-based competitors may be more likely to seek customers through mass marketing than through highly-targeted sales.

121. We do not establish rules pertaining to how an incumbent LEC might demonstrate that competitors "offer service" over their own facilities. As we note above, competitors are likely to market switched services broadly, thus we expect that competitors will advertise their services in a variety of media. These advertisements may well be probative of the extent of competitive offerings. Furthermore, incumbents are aware, of course, of competitors' purchase of unbundled loops, and the pending forbearance petitions suggest that they possess considerable intelligence regarding the extent and location of competitive facilities.

4. Phase I Relief

a. Introduction

122. Upon satisfaction of the Phase I triggers for particular services, we will permit price cap LECs to file, on one day's notice, tariffs offering volume and term discounts for those services, and we also will permit them to file contract tariffs for those services on one day's notice. Price cap LECs must remove their contract tariff offerings from price cap

relationship between collocation and total-facilities bypass-based entry in the switched access market.

regulation.[320] Currently, an incumbent LEC is free to lower its access rates as much as it wants,[321] provided that it lowers its rates throughout the study area or density pricing zone in question.[322] Under our Phase I regulatory relief, incumbent LECs are no longer required to choose between lowering a rate throughout the area at issue or not lowering the rate at all. Price cap LECs are required to maintain generally available tariffs subject to price cap regulation for all access services, however, so that access customers can choose between obtaining services pursuant to contract tariff or generally available tariff. This ensures that no access customer will be required to pay dramatically higher access rates as a result of Phase I pricing flexibility. In this section, we explain why we conclude that these two forms of relief are warranted in Phase I.

b. Volume and Term Discounts

123. *Background.* Price cap LECs currently may offer volume and term discounts for special access services without any competitive showing.[323] The Commission also permits incumbent LECs to offer cost-based volume and term discounts for several switched transport services[324] when competitors have purchased either (1) 100 DS1-equivalent switched transport cross-connects in the incumbent LEC's "zone 1" wire centers, or (2) an average of 25 DS1-equivalent switched transport cross-connects per zone 1 wire center.[325] By "cost-based"

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[320] Ad Hoc supports removing services offered under contract tariffs from price cap regulation. Ad Hoc Reply to U S West Phoenix Forbearance Petition, CC Docket No. 98-157, at 15-16. We address below the low-end adjustment issues raised by the removal of contract-tariff offerings from price cap regulation.

[321] In the *Price Cap Third Report and Order*, the Commission eliminated the lower service band indices. *Price Cap Third Report and Order*, 11 FCC Rcd at 21487-88.

[322] Section 69.3(e)(7) requires all incumbent LECs to charge uniform rates throughout each study area. *See* 47 C.F.R. § 69.3(e)(7). The Commission permitted incumbent LECs offering expanded interconnection to deaverage their special access and switched transport rates into three density pricing zones once demand for collocation services reached certain thresholds. *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7426-27; *Virtual Collocation Order*, 9 FCC Rcd at 5196-97; 47 C.F.R. §§ 61.47(e), 69.123. We relax these rules in Section III above, however.

[323] *See Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7458-65.

[324] These switched transport services are entrance facilities, interoffice mileage, and tandem-switched transport. *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7433-34.

[325] *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7434-36. In the *Special Access Expanded Interconnection Order*, the Commission allowed incumbent LECs with operational expanded interconnection offerings to implement a system of traffic-density-related rate zones, to bring special access rates more in line with costs. *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454. The Commission later expanded density zone pricing to switched transport. *See Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7426-27; *Virtual Collocation Order*, 9 FCC Rcd at 5196-97. For purposes of this Order, we use "zone 1" to refer to the zone with the heaviest traffic density.

discounts, the Commission meant that the discounts should be based on per-unit of capacity differences in embedded costs incurred to provide high-volume service relative to the costs of non-high-volume offerings.[326] In the *Access Reform NPRM*, the Commission invited comment on expanding volume and term discount authority upon satisfaction of Phase I triggers.[327]

124. *Discussion.* Upon satisfaction of the Phase I triggers, we find that price cap LECs should be permitted to offer volume and term discounts to enable them to respond to competition.[328] Prohibiting incumbent LECs from offering volume and term discounts when they have satisfied the Phase I triggers could distort the market for access services by preventing incumbent LECs from competing efficiently. In addition, permitting volume and term discounts creates little headroom that an incumbent could use to increase rates for other access services. For several years, the Commission has allowed volume and term discounts for certain access services in the trunking and traffic-sensitive baskets.[329] There is nothing in the record before us to suggest either that the headroom resulting from those discounts has led to unreasonable rate increases for other access services in those baskets, or that headroom resulting from expanded volume and term discount authority will lead to unreasonable rate increases for other access services in those baskets in the future. Unlike contract tariffs, moreover, volume and term discounts are not tailored to individual customers, and incumbent LECs must make them available to any customer with sufficient volumes or willing to commit to a given term.[330]

125. Several parties do not oppose volume and term discounts in their entirety, but rather oppose allowing volume and term discounts under conditions that might enable incumbent LECs to lock in customers or discriminate in favor of incumbents' long distance

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[326] *See Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7463; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7433.

[327] *Access Reform NPRM*, 11 FCC Rcd at 21435-38.

[328] *See* USTA Comments at 28, 49, and Att. 1 at 30-31; USTA Reply at 26-27; Citizens Comments at 17-18; PacTel Comments at 26; U S West Comments at 32-33; Ameritech Comments at 41 and Att. B at 36; BA/NYNEX Comments at 49; BA/NYNEX Reply at 23-24; BellSouth Comments at 33-34; Cincinnati Bell Comments at 18; GTE Comments at 48; SNET Comments at 18; SNET Reply at 14-15. This authority to offer volume and term discounts upon satisfaction of the Phase I triggers is in addition to the existing authority price cap LECs have to offer volume and term discounts.

[329] *See Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7458-65; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7433-34.

[330] Volume and term discounts for services in the common line basket raise issues that are not presented by volume and term discounts for services in the traffic-sensitive and trunking baskets. We address common line issues further in Section VI.D.3 of this Order, *infra*.

affiliates.[331] The Phase I triggers we adopt above condition incumbent LEC volume and term discounts upon irreversible, sunk investment by competitors, thus making it less likely that an incumbent will try to use volume and term discounts to lock in customers. In addition, section 202 of the Act[332] and our existing enforcement procedures are adequate to address unreasonable discrimination.[333]

126. According to MCI, the Commission proposed permitting volume discounts to facilitate the development of rate structures that reflect the manner in which costs are incurred. MCI argues further that the *Access Reform First Report and Order* eliminated inefficiencies in the common line and local switching rate structures, and so volume discounts are no longer warranted for these services.[334] Contrary to these arguments, however, the Commission proposed relaxing volume and term discount requirements not only to encourage incumbent LECs to develop efficient rate structures, but also to avoid distorting the market or impeding the development of effective competition.[335] Therefore, the rate structure revisions adopted in the *Access Reform First Report and Order* do not obviate the need for relaxing volume discount requirements.

127. The Illinois Commission supports permitting incumbent LECs to offer volume and term discounts, but it recommends setting a price floor at total service long incremental cost (TSLRIC), or some other measure of forward-looking economic costs, below which such discounts would not be permitted because they could be anticompetitive.[336] Historically, the Commission has required incumbent LECs to develop rate structures that reflect the manner in which they incur costs.[337] Rate structures that are not cost-based tend to result in implicit subsidies between high-volume and low-volume users.[338] We find that this concern is reduced, however, when the incumbent has met the Phase I trigger, because the existence of sunk investment by competitors limits the incentive to engage in anticompetitive pricing behavior. Furthermore, we will consider complaints filed under section 208 of the Act

[331] AT&T Comments at 80-81; MCI Comments at 58-59; Sprint Comments at 43-45; ACTA Comments at 18.

[332] 47 U.S.C. § 202.

[333] We address concerns regarding growth discounts below.

[334] MCI Nov. 9 Reply at 34-35 (citing *Access Reform First Report and Order*, 11 FCC Rcd at 21437).

[335] *Access Reform First Report and Order*, 11 FCC Rcd at 21437.

[336] Illinois Commission Comments at 21.

[337] Investigation of Interstate Access Tariff Non-Recurring Charges, CC Docket No. 85-166, Phase I, Part 3, 2 FCC Rcd 3498, 3501-02 (1987).

[338] *Access Reform First Report and Order*, 12 FCC Rcd at 15998.

alleging that a rate charged pursuant to a volume discount is unreasonably low, in violation of section 201 of the Act.[339] Moreover, any volume or term discount that results in a below-cost offering would give rise to an antitrust claim,[340] which provides further protection to competitors. As a result, we conclude that the benefits of permitting volume and term discounts without requiring a cost showing outweigh any possible costs. We will not require that LECs demonstrate that the volume and term discounts they may offer at Phase I are cost-based.

c. Contract Tariffs

128. Upon satisfaction of the Phase I triggers, we will permit price cap incumbent LECs to offer interstate access services pursuant to contract tariff. Access customers benefit from contract tariffs because they enable incumbent LECs to tailor services to their customers' individual needs. Incumbent LECs argue that they should be permitted to offer access services on a contract carriage basis, in part because these arrangements are common elsewhere in telecommunications and other industries.[341] We agree that, once competitors have made irreversible, sunk investments in their networks, continuing to prohibit incumbent LECs from offering services under contract tariff could reduce the efficiency of the market for access services by reducing the incumbent LECs' ability to meet customers' needs.

129. AT&T, Frontier, and MCI submit that incumbent LECs will be able to tailor contract carriage tariffs to such a point that additional customers are unlikely to select the tariff, leaving the incumbent LECs free to discriminate in favor of their affiliates.[342] Although any unreasonable restriction on the availability of contract tariff services would violate Section 202 of the Act,[343] and any party that believes that it may be disadvantaged by an allegedly discriminatory contract tariff offering may file a complaint under section 208 of the Act,[344] we agree that special safeguards are warranted with respect to contracts with affiliates. Permitting incumbent LECs to file contract tariffs on one day's notice provides little opportunity for the Commission or competing carriers to review the terms of the tariffs before they take effect. Issues regarding whether a particular tariff condition is unreasonably

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[339] *See* 47 U.S.C. §§ 201, 208.

[340] *See* 15 U.S.C. § 2; *In re* Air Passenger Computer Reservation Systems Antitrust Litigation, 694 F. Supp. 1443 (C.D. Cal. 1988), *aff'd*, 948 F.2d 536 (9th Cir. 1991).

[341] USTA Comments at 49; BA/NYNEX Comments at 51; BellSouth Comments at 35-36; Ameritech Reply at 12-13; GTE Reply, App. D at 13.

[342] AT&T Comments at 44-45; AT&T Reply at 45; Frontier Comments at 15; MCI Comments at 62. *See also* ACTA Comments at 18.

[343] 47 U.S.C. § 202.

[344] 47 U.S.C. § 208.

discriminatory and whether another carrier is in fact "similarly situated" may prove difficult to determine in a subsequent complaint proceeding, which, in any event, takes time to resolve. We adopt, instead, a bright-line rule to address concerns about discrimination in favor of affiliates. We will not permit an incumbent LEC to offer a contract tariff to an affiliate unless and until an unaffiliated customer first purchases service pursuant to that contract.[345]

130. MCI contends that, if price cap LECs are permitted to offer contract tariffs before there is substantial competition in the market, those LECs will deter market entry through targeted rate reductions.[346] We adopt Phase I triggers to ensure that incumbent LECs cannot drive competitors from the market through targeted rate reductions; these safeguards are adequate to address MCI's concern. Moreover, to the extent that an incumbent LEC attempts to use contract tariffs in an exclusionary manner by targeting them to specific customers, the Commission will enforce the requirement that they make contract tariffs available to all similarly situated customers.[347]

131. Intermedia argues that granting incumbent LECs contract tariff authority will result in a price squeeze with respect to facilities-based CLECs that purchase UNEs, because the Commission has adopted average variable cost as a price floor for incumbent LEC wholesale and retail rates.[348] According to Intermedia, CLECs providing service through the use of unbundled network elements are unable to compete with incumbent LEC services priced at average variable cost, because the Commission's pricing methodology for UNEs, Total Element Long Run Incremental Cost (TELRIC), includes costs, including joint and common costs, depreciation, and a reasonable profit,[349] that are excluded from the calculation of average variable cost.[350] Intermedia proposes that the Commission address this price squeeze by requiring resale, at a wholesale discount, of all incumbent LEC contract tariff offerings and volume and term discounts.[351] Intermedia's concerns about potential a potential price squeeze are best addressed in the context of a complaint filed under section 208 of the Act alleging that a rate charged pursuant to a contract tariff or volume or term discount is

[345] Once the Commission grants BOCs permission, pursuant to section 271 of the Act, 47 U.S.C. § 271, to provide in-region long distance services, they are required to offer those services through separate affiliates. *See* 47 U.S.C. § 272. Similarly, the Commission's rules require incumbent independent (non-BOC) LECs to offer in-region long distance services through separate affiliates. *See* 47 C.F.R. § 64.1903.

[346] MCI Oct. 26 Comments at 61-62. *See also* Time Warner Oct. 26 Comments at 14-16.

[347] *See Interexchange Competition Order*, 6 FCC Rcd at 5897.

[348] Intermedia *ex parte* statement of July 14, 1999, at 2.

[349] *See Local Competition Order*, 11 FCC Rcd at 15850-56.

[350] Intermedia *ex parte* statement of July 14, 1999, at 2.

[351] *Id.* at 4-5.

unreasonably low and thus violates section 201.[352] We note in this regard that such a complaint is not subject to dismissal merely because a given rate is at or above average variable cost; average variable cost is not necessarily a "reasonable" rate.

132. MCI and Time Warner argue that AT&T was permitted to offer contract tariff service only when the Commission found that AT&T faced "substantial competition," and that allowing incumbent LECs to offer contract carriage on a lesser showing is inconsistent with that precedent.[353] We find that the precedent cited by MCI and Time Warner is not entirely on point, because, in contrast to the relief granted to AT&T, Phase I relief does not permit price cap LECs to provide services completely outside of price cap regulation.[354] Rather, price cap LECs will be required to maintain generally tariffed access service offerings subject to price cap regulation. Because we are granting incumbent LECs much less pricing flexibility at Phase I than the Commission granted AT&T pursuant to the *Interexchange Competition Order*, we do not require price cap LECs to show that they face substantial competition.

133. Ameritech and Bell Atlantic also seek permission to respond to requests for proposals (RFPs).[355] We find that the contract tariff authority we grant here is sufficient to enable price cap LECs to respond to RFPs, and so we need not grant any further pricing flexibility for this purpose. ALTS maintains that granting flexibility to respond to RFPs is inconsistent with a previous Commission Order terminating an investigation, in which the Commission concluded that a Southwestern Bell tariff revision designed to respond to RFPs was unreasonably discriminatory.[356] ALTS's concern is unfounded. First, Southwestern Bell sought to respond to any RFP that indicated that the request involved a competitive situation.[357] Unlike the Phase I triggers we adopt in this Order, Southwestern Bell's tariff did not in any way indicate whether its competitors had made irreversible investment in facilities. Second, the Commission's decision rested in part on Southwestern Bell's failure to submit

[352] *See* 47 U.S.C. §§ 201, 208.

[353] MCI Comments at 60-61; Time Warner Comments at 31-33; MCI Nov. 9 Reply at 41 (citing *Interexchange Competition Order*, 6 FCC Rcd 5880).

[354] *See Interexchange Competition Order*, 6 FCC Rcd at 5894.

[355] Bell Atlantic *ex parte* statement of April 27, 1998, at 22; Ameritech *ex parte* statement of June 5, 1998, at 3.

[356] ALTS *ex parte* statement of June 25, 1999, at 25 (quoting Southwestern Bell Telephone Company, CC Docket No. 97-158, Order Concluding Investigation and Denying Application for Review, 12 FCC Rcd 19311, 19336 (1997) (*Southwestern Bell Transmittal 2633 Order*)).

[357] *See Southwestern Bell Transmittal 2633 Order*, 12 FCC Rcd at 19317.

adequate evidence of competition in its region at that time.[358] The Commission did not decide, as ALTS seems to imply, that any RFP authority is inherently unreasonable. Finally, the Commission noted the pendency of this rulemaking proceeding, and that the record in this proceeding might provide a basis for permitting contract tariffs or competitive response tariffs.[359] Thus, rather than precluding consideration of this RFP issue, the *Southwestern Bell Transmittal 2633 Order* expressly contemplated addressing that issue in this Order.

d. Growth Discount

134. We reject Ameritech's and Bell Atlantic's proposal to allow incumbent LECs to offer growth discounts.[360] Growth discounts refer to pricing plans under which incumbent LECs offer reduced per-unit access service prices to customers that commit to purchase a certain percentage above their past usage, or plans that offer reduced prices based on growth in traffic placed over an incumbent LEC's network.[361] The Commission tentatively decided not to permit growth discounts in the *Access Reform NPRM*, because they create an artificial advantage for BOC long distance affiliates with no subscribers, relative to existing IXCs and other new entrants.[362] The Commission also invited parties to comment on whether growth discounts would enhance the development of competitive access markets.[363]

135. None of the parties supporting growth discounts explains why growth discounts enhance the development of competitive access markets. Instead, Ameritech asserts that the Commission could rely on the tariff review process to ensure that any growth discounts do not unreasonably advantage the incumbent LEC's long distance affiliate.[364] Without any affirmative benefit to growth discounts presented in the record before us, we have no basis for allowing such discounts.

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[358] *Id.* at 19334-35.

[359] *Id.* at 19339.

[360] Bell Atlantic *ex parte* statement of April 27, 1998, at 21, 29; Ameritech Oct. 26 Comments, Att. N at 9-10.

[361] *Access Reform NPRM*, 11 FCC Rcd at 21437.

[362] *Id.* at 21437-38.

[363] *Id.* at 21438.

[364] Ameritech Oct. 26 Comments, Att. N at 9-10.

e. X-Factor Reductions

136. Ameritech, Bell Atlantic, and USTA recommend reducing or eliminating the X-Factor in the price cap index (PCI) formula as competition grows.[365] This regulatory relief is not warranted. Phase I pricing flexibility is designed to grant incumbent LECs more flexibility to lower prices for particular customers without subjecting other customers to higher rates. Because competition may not be sufficient to constrain prices throughout an MSA at Phase I, we require LECs to maintain their generally available tariffs in order to protect access customers. If we were to lower the X-Factor as competition increases, then the price cap-constrained tariffs might not be adequate to protect access customers from rate increases.

137. Ameritech maintains that the X-Factor should be eliminated in its proposed "Phase II," which is roughly analogous to our Phase I, because competitive pressures will constrain the incumbent LEC's ability to earn excessive profits.[366] We find this reasoning unpersuasive, because the services for which the incumbent feels competitive pressure are the ones most likely to be offered under contract tariff, outside of price cap regulation. Therefore, the services that remain subject to price cap regulation are likely to be those for which the incumbent faces less competition.

138. Moreover, the Commission designed price cap regulation in part to replicate, to the extent possible, the results of a competitive market.[367] Generally, as more competitors enter a market, supply increases, and this additional supply puts downward pressure on prices. Conversely, lowering the X-Factor decreases downward pressure on prices. Thus, lowering the X-Factor as competition increases would produce exactly the opposite result of a competitive market, thereby undercutting one of the Commission's goals in adopting price cap regulation.

f. Other Price Cap Revisions

139. We reject the proposal by several LECs to consolidate the existing price cap baskets into one basket.[368] Ameritech states that this restructuring would permit incumbent

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[365] Ameritech *ex parte* statement of June 5, 1998, at 3; Bell Atlantic ex parte statement of April 27, 1998, at 10; USTA Oct. 26 Comments at 37 and Att. E; *see also* SBC Oct. 26 Comments at 20. In price cap regulation, the "X-Factor" limits access rate increases. Access services are grouped into "baskets," and the weighted average of the rates in each basket may not exceed the price cap index (PCI). The PCI is adjusted annually by a measure of inflation minus the X-Factor. *See Price Cap Fourth Report and Order*, 12 FCC Rcd at 16647-48.

[366] Ameritech Oct. 26 Comments, Att. N at 9-10.

[367] *LEC Price Cap Performance Review*, 10 FCC Rcd at 9002.

[368] Ameritech Oct. 26 Comments, Att. N at 9-10; USTA Oct. 26 Comments at 37, Att. E; SBC Oct. 26 Comments at 20.

LECs to raise prices for some services to offset reductions in prices for other services.[369] Nothing in the record suggests that the customers facing increased prices under this kind of pricing flexibility are likely to have many competitive alternatives relative to customers that benefit from price reductions. Thus, consolidating price cap baskets would deprive access customers of protection that remains necessary at Phase I.

140. For similar reasons, we also decline to adopt Bell Atlantic's suggestion that we increase upper service band index (SBI) limits to 10 percent per year for transport services upon satisfaction of its proposed "Phase II" triggers, which are similar to the Commission's Phase I triggers.[370] Increasing the upper SBI limits upon satisfaction of our Phase I triggers could enable the incumbent LEC to increase a customer's access rates before that customer has a competitive alternative.[371]

5. Phase II for Special Access and Dedicated Transport

a. Introduction

141. We adopt Phase II triggers comparable to our Phase I triggers: we will grant Phase II pricing flexibility to incumbent LECs when competitors have collocated in a certain percentage of the incumbent's wire centers in an MSA, or in wire centers generating a certain percentage of an incumbent's revenues for the services at issue within the MSA. Because Phase II grants incumbent LECs considerably greater flexibility than Phase I, we adopt triggers to ensure that competitors have established a significant market presence, *i.e.*, that competition for a particular service within the MSA is sufficient to preclude the incumbent from exploiting any monopoly power over a sustained period.[372] Upon a Phase II showing for special access and dedicated transport services within an MSA, we will relax the price cap rules and the Part 69 rate structure requirements applicable to those services in that MSA.[373]

142. By significant market presence, we mean that IXCs have a competitive alternative for dedicated transport services needed to reach the majority, although not necessarily all, of their long distance customers throughout the MSA, and that almost all special access customers have a competitive alternative. We find that Phase II regulatory

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[369] Ameritech Oct. 26 Comments, Att. N at 9-10.

[370] Bell Atlantic *ex parte* statement of April 27, 1998, at 21.

[371] *See* Ad Hoc Oct. 26 Comments at 30.

[372] As we explain further in this Order below, determining that an incumbent LEC cannot exploit monopoly power over a sustained period is not equivalent to finding that carrier to be non-dominant. *See* Section VI.C.4.b, *infra*.

[373] Part 69 does not prescribe a rate structure for special access services.

relief is warranted upon satisfaction of the Phase II triggers within an MSA, even though such relief might lead to higher rates for access to some parts of an MSA that lack a competitive alternative, for several reasons. First, the customers for the services we address in this section are IXCs and large businesses, not residential or small business end users. These large and sophisticated customers generate significant revenues for the incumbent and are not without bargaining power with respect to the incumbent.

143. Second, delaying Phase II regulatory relief until access customers have a competitive alternative for access to each and every end user might give competitors the ability to "game the system." In other words, competitors might be able to prevent an incumbent from obtaining pricing flexibility in an MSA simply by choosing not to enter certain parts of that MSA or to serve certain customers. We will not distort the operation of the market in this manner.

144. Finally, because regulation is not an exact science,[374] we cannot time the grant of regulatory relief to coincide precisely with the advent of competitive alternatives for access to each individual end user. We conclude that the costs of delaying regulatory relief outweigh the potential costs of granting it before IXCs have a competitive alternative for each and every end user. The Commission has determined on several occasions that retaining regulations longer than necessary is contrary to the public interest. Almost 20 years ago, the Commission determined that regulation imposes costs on common carriers and the public, and that a regulation should be eliminated when its costs outweigh its benefits.[375] More recently, the Commission recognized that retaining tariffing requirements for non-dominant IXCs imposes costs in the form of a less efficient market.[376] In Section III of this Order, we conclude that the new service rules currently in effect limit incumbents' incentives to innovate. The Part 69 rate structure can impose costs on an incumbent LEC by limiting its ability to develop rate structures in response to market forces. Thus, retaining the Part 69 rate structure imposes costs on society by perpetuating inefficiencies in the market for interstate access services. The triggers we adopt for Phase II flexibility are sufficient to ensure that incumbent LECs cannot exercise any remaining monopoly power indefinitely. If an incumbent LEC charges an unreasonably high rate for access to an area that lacks a competitive alternative, that rate will induce competitive entry, and that entry will in turn

[374] *United States v. FCC*, 707 F.2d at 618.

[375] Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, First Report and Order, 85 FCC 2d 1, 3 (1980) (*Competitive Carrier First Report and Order*). The Court later overturned this Order, but only because the Commission did not have authority under the Communications Act at that time to forbear from regulation, not because it erred in determining that the costs of regulation can outweigh its benefits. *See* MCI v. FCC, 765 F.2d 1186, 1195-96 (D.C. Cir. 1985); AT&T v. FCC, 978 F.2d 727, 736 (D.C. Cir. 1992).

[376] Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-61, Second Report and Order, 11 FCC Rcd 20730, 20762-63 (1996).

drive rates down. Accordingly, we will not delay Phase II regulatory relief until access customers have a competitive alternative for access to every end user.

145. As we did in Phase I, we establish different triggers for (1) special access services (other than channel terminations) and dedicated transport services, and (2) channel terminations. In this section of the Order, we adopt triggers for each of these services and adopt specific forms of regulatory relief for Phase II. In the Notice accompanying this Order, we invite interested parties to comment on Phase II triggers for other switched access services.

b. Phase II Triggers

146. We note above that the regulatory relief proposed by Ameritech and Bell Atlantic for "Phase II" is analogous to our Phase I relief. Here, we find that Ameritech's and Bell Atlantic's Phase III proposals are analogous to the Phase II relief we adopt here.[377] Therefore, we rely in part on the record developed in response to Bell Atlantic's and Ameritech's proposals in developing our Phase II triggers. Bell Atlantic proposes granting relief when competitors have collocated facilities, purchased UNEs, or installed their own facilities in 75 percent of the wire centers in the market area.[378] Ameritech recommends granting relief when competitors have collocated in wire centers serving 75 percent of the demand in a market area, measured on a DS1-equivalent basis.[379]

147. Access customers must have competitive alternatives throughout most of an MSA before we can grant Phase II regulatory relief to an incumbent LEC. The Ameritech and Bell Atlantic proposals recognize that our Phase II triggers must be high enough to ensure that competitive alternatives for the services at issue exist in the area for which flexibility is granted. The triggers we adopt, however, differ from those recommended by these incumbent LECs in two respects: as in Phase I, (1) we base our Phase II triggers on collocation in either a certain percentage of wire centers in an MSA, or in wire centers generating a certain percentage of the revenues for the services at issue in an MSA; and (2) we conclude that different services warrant different thresholds.

[377] In addition to all the forms of regulatory relief we grant immediately in Sections III and V of this Order and that we will grant upon satisfaction of Phase I triggers, in Phase II, we will (1) relax our Part 69 rate structure rules, and (2) permit price cap LECs to offer access services completely outside of price cap regulation. Ameritech and Bell Atlantic recommend removing services from price cap regulation upon demonstration that an incumbent LEC has met their Phase III criteria. Ameritech *ex parte* statement of June 5, 1998, at 3; Bell Atlantic *ex parte* statement of April 27, 1998, at 22. USTA also recommends removing services from price caps upon its Phase III showing, and recommends eliminating Part 69 rate structure requirements upon a Phase I showing. USTA Oct. 26 Comments at Att. E.

[378] Bell Atlantic *ex parte* statement of April 27, 1998, at 21.

[379] Ameritech *ex parte* statement of June 5, 1998, at 2.

148. We determined in our Phase I analysis above that evidence of collocation may underestimate the extent of competitive facilities within a wire center, because it fails to account for the presence of competitors that have wholly bypassed incumbent LEC facilities. For this reason, we adopt a threshold lower than the 75 percent recommended by Ameritech and Bell Atlantic. For dedicated transport, and for special access services other than channel terminations, we grant Phase II pricing flexibility to incumbent LECs that demonstrate that competitors have collocated in 50 percent of an incumbent LEC's wire centers in the MSA at issue. SBC has shown that competitors have collocated in 51 percent of its wire centers in the San Diego MSA.[380] According to SBC, competitors' networks in this MSA comprise at least 1150 route miles, and there are more than 360 buildings on those networks.[381] Similarly, competitors have collocated in 58 percent of SBC's wire centers in the Los Angeles MSA.[382] SBC submits that competitors' networks in this MSA comprise more than 2530 route miles, and there are more than 950 buildings on those networks.[383] We explain above that establishing an operational collocation arrangement requires considerable time and expense.[384] This evidence suggests that collocation in 50 percent of an incumbent LEC's wire centers corresponds to considerable investment by competitors in transmission facilities and the ability of competitors to serve customers in a large number of buildings.

149. As we explain in our Phase I discussion, a few wire centers may account for a disproportionate share of revenues for a particular service. For this reason, we also will grant Phase II pricing flexibility for these services upon a demonstration that competitors have collocated in wire centers accounting for 65 percent of the incumbent LEC's revenues from those services in an MSA. Similarly, we will grant Phase II pricing flexibility for channel terminations between an IXC POP and a LEC serving wire center when an incumbent demonstrates that competitors have collocated in 50 percent of its wire centers in an MSA, or in wire centers accounting for 65 percent of the incumbent's revenue for this service. As we explained in our discussion of Phase I triggers above, these services carry traffic between points of high traffic concentration and therefore warrant lower triggers than those we adopt for channel terminations between a LEC end office and a customer premises.

150. We adopt higher thresholds for channel terminations between an incumbent LEC's end office and customer premises, for the reasons we offered in our Phase I analysis. For these channel terminations, Phase II relief is available to LECs that demonstrate that

[380] SBC Reply in SBC Forbearance Proceeding, CC Docket No. 98-227, Att. 2.

[381] SBC Forbearance Petition, Att. A at 10.

[382] SBC Reply in SBC Forbearance Proceeding, CC Docket No. 98-227, Att. 2. For purposes of its forbearance petition, SBC treats the Long Beach and Orange County MSAs as one MSA.

[383] SBC Forbearance Petition, Att. A at 10.

[384] Section VI.C.2, *supra*.

competitors have collocated in 65 percent of the incumbent LEC's wire centers in the MSA at issue, or in wire centers accounting for 85 percent of the incumbent's revenues from those services in that MSA. Because these services do not carry traffic between points of high traffic concentration, and because the collocated competitors still rely on incumbent LEC facilities to reach the end user, we find that higher thresholds are warranted.

151. MCI argues that price cap LECs should be permitted Phase II regulatory relief, such as removal of services from price cap regulation, only when those LECs are "non-dominant," *i.e.*, no longer have market power in the provision of the services at issue.[385] We conclude that the Phase II regulatory relief we grant below is warranted when competitors have established a significant market presence in an MSA, and we need not require a showing of non-dominance. Upon a Phase II showing, we will not grant incumbent LECs all the regulatory relief we afford to non-dominant carriers. Specifically, incumbent LECs in Phase II are still required to file generally available tariffs, while non-dominant LECs and CAPs are permitted, but not required, to file tariffs.[386] Furthermore, our relief is limited to certain services and certain areas, and will be granted only upon satisfaction of the triggers we adopt here. Thus, Phase II relief is not tantamount to non-dominant treatment.

152. In the *Interexchange Competition Order*, the Commission allowed AT&T to remove some interexchange services from price cap regulation based on a finding of "substantial competition," but it based that finding on a more detailed analysis than the Phase II triggers we adopt here, including an examination of, *inter alia*, demand and supply elasticities, pricing behavior, and market share.[387] We conclude that this detailed substantial competition test is not warranted for special access and dedicated transport services because we grant incumbent LECs pricing flexibility only on a MSA-by-MSA basis, while the Commission granted AT&T pricing flexibility on a nationwide basis. Furthermore, the administrative burdens of a detailed substantial competition test are magnified when done on an MSA-by-MSA basis, and we believe our collocation-based triggers are sufficient to ensure that we do not grant pricing flexibility prematurely. Accordingly, we will rely on collocation-based triggers to indicate when competitors have established a significant market presence that warrants Phase II relief for special access and dedicated transport services.[388]

[385] MCI Oct. 26 Comments at 48.

[386] *See* Hyperion Telecommunications, Inc. Petition Requesting Forbearance, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 12 FCC Rcd 8596, 8611-12 (1997).

[387] *See Interexchange Competition Order*, 6 FCC Rcd at 5887-93.

[388] We seek comment on Phase II relief for common line and traffic-sensitive services in the accompanying Notice.

c. Phase II Relief

153. Upon satisfaction of the Phase II triggers we adopt above for special access and dedicated transport services, we will no longer require price cap LECs to comply with our Part 69 rate structure rules or Part 61 price cap rules with respect to those services within an MSA. An incumbent LEC should be permitted to remove services from price cap regulation when that LEC's competitors have established a significant market presence in the provision of those services.[389] A significant market presence in an MSA ensures that the incumbent will not be able to exploit any monopoly power for a sustained period. We will, however, continue to require LECs to maintain generally available tariffs, but we will permit them to file such tariffs on one day's notice. In this section, we explain why we conclude that these two forms of relief are warranted upon satisfaction of the Phase II triggers.

154. Currently, Part 69 of the Commission's rules prescribes a rate structure for all switched access services, including dedicated transport. USTA recommends eliminating the Part 69 rate structure as a form of regulatory relief.[390] In addition, in Section III above, we eliminate rate structure requirements for new services. We agree that elimination of our Part 69 rate structure rules for existing dedicated transport services is warranted, but not until the incumbent LEC meets our Phase II requirements. As explained in more detail in Section VIII.C. below, a rate structure can create implicit subsidies if it does not reflect accurately the manner in which incumbent LECs incur the costs of providing a service. Therefore, rate structure rules are necessary in the absence of a significant market presence by competitors. Once competitors have established a significant market presence in an MSA, however, we believe it is no longer necessary to impose efficient rate structures on incumbent LECs. Therefore, we will eliminate our rate structure rules for particular services once an incumbent LEC demonstrates the development of a significant market presence by competitors for those services by satisfying the Phase II trigger. Retaining our price cap and rate structure rules until LECs are non-dominant is unwarranted because doing so would delay the action of competition in setting efficient rate levels and rate structures.

155. We recognize that the regulatory relief we grant upon a Phase II showing may enable incumbent LECs to increase access rates for some customers. We conclude that this relief nonetheless is warranted upon a Phase II showing for two reasons. First, some access rate increases may be warranted, because our rules may have required incumbent LECs to price access services below cost in certain areas. Second, we find that a Phase II showing is sufficient evidence that competitors' market presences have become significant, and that the public interest is better served by permitting market forces to govern the rates for the access services at this point. In addition, we note that these services generally are purchased by

[389] In the *LEC Price Cap Order*, the Commission explained that it is unnecessary to extend the efficiency incentives of price cap regulation to services offered on a "contract-type basis." *LEC Price Cap Order*, 5 FCC Rcd at 6810.

[390] USTA Oct. 26 Comments, Att. E.

IXCs, not individual end users. IXCs are sophisticated purchasers of telecommunications services, fully capable of finding competitive alternatives where they exist and determining which competitor can best meet their needs.

156. We decline to adopt any other Phase II regulatory relief proposed in the *Access Reform NPRM.* Two of those proposals, elimination of price cap service categories[391] and consolidation of price cap baskets,[392] are not relevant because Phase II relief removes services from price cap regulation.

157. The *Access Reform NPRM* also proposed allowing incumbent LECs to charge IXCs different rates for access to different classes of end user.[393] Ameritech argues that class-of-customer pricing would enable incumbent LECs to respond to competition.[394] We find that the pricing flexibility we grant in Phase I and Phase II is sufficient to enable incumbent LECs to respond to competition. Bell Atlantic argues that class-of-customer pricing is simply another form of deaveraging.[395] We grant price cap LECs considerable flexibility to deaverage their rates in Section V of this Order, and Bell Atlantic does not explain why deaveraging by class of customer is necessary to enable incumbent LECs to respond to competition. Thus, the record does not provide a basis for granting this relief.

D. Price Cap Issues

1. Revision of Price Cap Indices

158. We have determined that no adjustment to price cap LECs' PCIs is warranted when a LEC removes demand associated with services offered pursuant to contract tariff from a price cap basket, or when an entire service is removed from price cap regulation pursuant to a Phase II showing. When the Commission permitted AT&T to remove commercial long distance services from price cap regulation, it did not require AT&T to make any exogenous cost adjustment to the PCI for the basket from which those services were removed.[396] Specifically, the Commission found that the removal of an individual service from a basket

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[391] *Access Reform NPRM,* 11 FCC Rcd at 21445.

[392] *Id.* at 21447-48.

[393] Specifically, the Commission proposed allowing incumbent LECs to charge an IXC different rates for local switching and transport services based on the class of end user to which the IXC provides long distance service. *Id.* at 21445-46.

[394] Ameritech Comments at 46.

[395] BA/NYNEX Comments at 51. *See also* USTA Comments at 28.

[396] Revisions to Price Cap Rules for AT&T Corp., CC Docket No. 93-197, Report and Order, 10 FCC Rcd 3009, 3019 (1995) (*Commercial Services Order*).

has no effect on the PCI, and it affects the API only by altering the base period revenue weights of the services remaining in the basket at the time a carrier revises some other rate in that basket.[397] Thus, removing individual services from price cap regulation has only a *de minimis* effect on the headroom for the services remaining in the basket.[398]

159. In accordance with this precedent, we do not require incumbent LECs to make any exogenous adjustment to their PCIs to reflect the removal of demand associated with contract tariff services from price cap regulation. Although the Commission did require a "recalibration" of AT&T's PCIs when other services were removed from price cap regulation,[399] we find that the recalibration required by those Orders is not needed for removal of contract tariff demand. In those cases, the Commission removed all the services except one service category from the basket in question. Because the service band indices (SBIs) were designed to limit cross-subsidization between different types of services within a basket, and there is no danger of cross-subsidization when there is only one service category remaining in the basket, the Commission recalibrated AT&T's PCIs and APIs to eliminate the SBI for the remaining basket without affecting the headroom AT&T had previously.[400] In the case of the relief we provide here, however, incumbent LECs will remove only some demand for some services from a basket; therefore, we will retain the SBIs, and there is no need for the recalibration we required of AT&T.

2. Low-End Adjustment Mechanism

160. *Background.* In the *LEC Price Cap Order*, the Commission adopted the low-end adjustment mechanism, which permits incumbent LECs earning rates of return less than 10.25 percent in a given year to increase their PCIs to a level that would enable them to earn 10.25 percent.[401] The Commission decided to retain the low-end adjustment mechanism in the *Price Cap Fourth Report and Order*, to prevent confiscatory price cap rates in cases where differences in economic conditions in different price cap LECs' service regions might cause a LEC to earn a confiscatory return in a given tariff year.[402]

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[397] *Commercial Services Order*, 10 FCC Rcd at 3019.

[398] *See also* USTA *ex parte* statement of Jan. 27, 1999; U S West *ex parte* statement of Jan. 28, 1999.

[399] *Interexchange Competition Second Report and Order*, 8 FCC Rcd at 3671 (removal of all services except 800 directory assistance from Basket 2); *AT&T Non-DominantReinitialization Order*, 11 FCC Rcd 1201 (removal of services except international services from Basket 1).

[400] *Interexchange Competition Second Report and Order*, 8 FCC Rcd at 3671; *AT&T Non-Dominant Reinitialization Order*, 11 FCC Rcd at 1201.

[401] *LEC Price Cap Order*, 5 FCC Rcd at 6804.

[402] *See Price Cap Fourth Report and Order*, 12 FCC Rcd at 16691, 16704-05; *Price Cap Performance Review*, 10 FCC Rcd at 9048.

161. In its petition for reconsideration of the *Price Cap Fourth Report and Order*,[403] AT&T questions whether it is reasonable to retain the low-end adjustment mechanism after the elimination of sharing.[404] In this Order, for the reasons discussed below, we partially grant AT&T's petition on this issue. We will consider other issues raised in AT&T's petition, along with other petitions for reconsideration of the *Price Cap Fourth Report and Order*, in a future Order.

162. *Discussion.* We eliminate the low-end adjustment mechanism for price cap LECs that qualify for and elect to exercise either the Phase I or Phase II pricing flexibility we grant in this Order.[405] AT&T argues that the low-end adjustment mechanism blunts efficiency incentives just as sharing does and that, therefore, retaining it is inconsistent with the Commission's decision to eliminate sharing.[406] AT&T also notes that several LECs opposed retention of the low-end adjustment mechanism, and those that supported it did so only as a means to provide "symmetry" to the sharing obligation.[407] AT&T requests that we eliminate the low-end adjustment mechanism or re-introduce sharing.[408]

163. We conclude that we should eliminate the low-end adjustment mechanism once price cap LECs qualify for and choose to exercise either the Phase I or Phase II pricing flexibility we grant in this Order. We agree with AT&T that the low-end adjustment mechanism tends to blunt efficiency incentives. We also conclude that this effect will be exacerbated by removing contract tariff services from price cap regulation, so that retention of the mechanism would be unreasonable for price cap LECs obtaining pricing flexibility. The low-end adjustment mechanism can create undesirable incentives for price cap LECs when

[403] *Price Cap Fourth Report and Order*, 12 FCC Rcd 16642. For purposes of this Section VI.D.2 of the Order, except as otherwise noted, "Petition" refers to petitions for reconsideration of the *Price Cap Fourth Report and Order* filed July 11, 1997, "Comments" refers to comments filed in response to those petitions on August 18, 1997, and "Reply" refers to replies filed in response to those petitions on September 3, 1997.

[404] AT&T Petition at 13-16. When price cap regulation included sharing obligations, incumbent LECs were required to "share" half or all their earnings above specified rates of return with their access customers through lower PCIs during the following year. *See Price Cap Fourth Report and Order*, 12 FCC Rcd at 16649. The Commission eliminated sharing obligations in the *Price Cap Fourth Report and Order*, in part because the benefits derived from those obligations were reduced by the adoption of an X-Factor based on a more accurate measure of productivity growth and elimination of multiple X-Factor options. As a result, the efficiency-blunting effects of sharing began to outweigh its benefits. *Id.* at 16699-702.

[405] Streamlined treatment of new services, removal of interexchange services from price caps, and geographic deaveraging of rates for services in the trunking basket do not affect a LEC's entitlement to a low-end adjustment.

[406] AT&T Petition at 13-15.

[407] *Id.* at 13-14; AT&T Reply at 6-7.

[408] AT&T Petition at 15-16.

they move some demand for some services out of price cap regulation. The low-end adjustment is a rate-of-return-based mechanism, and it therefore recreates some of the incentives of rate-of-return regulation, although not to the same extent as sharing obligations.[409] Earnings from non-price cap services are currently not considered part of "total interstate earnings"[410] for purposes of calculating low-end adjustments.[411] As a result, price cap LECs must remove the costs of non-price cap services in order to calculate interstate earnings, and they have an incentive to underallocate those costs in order to minimize measured earnings. Currently, this underallocation incentive is not a serious concern, because non-price cap services represent a very small fraction of the price cap LECs' federally tariffed activities, and so the effects of any underallocation are minimal.[412] Once a LEC has removed a significant amount of demand associated with contract tariff offerings from price cap regulation, however, its incentive to underallocate the costs of non-price cap services and the effects of such underallocation will be greater.

164. Our decision to eliminate the low-end adjustment mechanism for parties obtaining pricing flexibility is consistent with a proposal made by the Ad Hoc Telecommunications Users Committee (Ad Hoc) in response to the *Access Reform NPRM.* Ad Hoc argues that incumbent LECs either should be guaranteed a just and reasonable rate of return and recovery of all of their prudent investment, or they should be permitted to pursue market opportunities and maximize their earnings, but not both.[413] Ad Hoc reasons that an incumbent LEC permitted unlimited profits under price cap regulation should not be shielded

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[409] The Commission has concluded that sharing obligations severely blunt the efficiency incentives that it sought to create when it adopted price cap regulation, by requiring price cap LECs earning more than certain rates of return to share half or all those earnings with their customers. *Price Cap Fourth Report and Order*, 12 FCC Rcd at 16699; *LEC Price Cap Performance Review*, 10 FCC Rcd at 9045-46. The low-end adjustment mechanism does not blunt efficiency incentives as much as sharing because it guarantees only a 10.25 percent rate of return, and price cap LECs should be able to achieve much greater profits by trying to increase their productivity growth.

[410] In the *LEC Price Cap Reconsideration Order*, the Commission explained that sharing and the low-end adjustment mechanism are based on total interstate earnings rather than basket-by-basket earnings. *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2679-80. *See also LEC Price Cap Order*, 5 FCC Rcd at 6805. The Commission also determined that sharing and the low-end adjustment mechanism should be based on earnings from all services subject to price cap regulation, rather than earnings exclusively from access services. *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2680-81.

[411] *See LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2681 n.126. Earnings from services excluded from price cap regulation also are excluded from total interstate earnings for purposes of calculating low-end adjustments. *Id.* at 2681-82.

[412] *LEC Price Cap Order*, 5 FCC Rcd at 6810.

[413] Ad Hoc Comments at 66-69.

from any risk of stranded investment.[414] Alternatively, Ad Hoc argues that an incumbent LEC seeking some stranded investment recovery should be subject to 100 percent sharing obligations for all earning in excess of 50 basis points over the authorized rate of return.[415] Although we decline to reimpose sharing obligations, we agree with Ad Hoc that an incumbent LEC seeking pricing flexibility to compete more vigorously in the marketplace should not be afforded any rate-of-return-based protection from any risk associated with its competitive ventures.[416]

165. We have considered whether it is possible to modify the low-end adjustment mechanism to limit the undesirable incentives discussed above. For example, USTA proposed requiring price cap LECs to maintain records regarding demand for services removed from price cap regulation, but permitting them to keep that information confidential. Under USTA's proposal, a price cap LEC seeking to make a low-end adjustment would be required to re-price its removed service demand at an "average price cap tariff rate."[417] It would be difficult, however, for the Commission or other interested parties to verify that a price cap LEC claiming a low-end adjustment has re-priced its contract tariff demand properly. Specifically, whenever a contract tariff offering is a package of two or more access services, USTA's proposal requires the incumbent to allocate the contract rate among the services in the package. It would be difficult for the Commission to determine whether that allocation is reasonable, particularly in cases where the package includes nonregulated services and services removed from price cap regulation pursuant to a grant of pricing flexibility. Therefore, USTA's proposal would not be an adequate safeguard against cross-subsidization.

166. The other possible safeguard that we have considered would require the Commission to specify the cost allocation rules LECs would use to segregate costs and revenues from services in price cap regulation from the costs and revenues of services outside of price cap regulation. Such rules would be burdensome for carriers and the Commission and is inconsistent with the deregulatory framework envisioned by Congress when it adopted the Telecommunications Act of 1996. Indeed, we find that such cost accounting rules would make using the low-end adjustment mechanism just as burdensome as making an above-cap filing. We have retained the low-end adjustment mechanism in part to avoid costly above-cap

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[414] *Id.* 67-68.

[415] *Id.* at 67.

[416] Courts also have held that a utility company's captive customers should bear the risk of loss of the utility's investment only if those customers also are permitted to share in the benefits resulting from that investment. *See* Democratic Cent. Comm. of the Dist. of Columbia v. Washington Metro. Area Transit Comm'n, 485 F.2d 786, 805 (D.C.Cir.1973), *cert. denied,* 415 U.S. 935 (1974); AT&T Info. Sys., Inc. v. FCC, 854 F.2d 1442, 1444 (D.C. Cir. 1988).

[417] USTA *ex parte* statement of Jan. 27, 1999, at 3-4.

filings.[418] Burdening the low-end adjustment mechanism with cost allocation rules thus would undercut a major reason for retaining the low-end adjustment mechanism as part of the price cap plan. On the other hand, elimination of the low-end adjustment mechanism for an incumbent LEC might enable the Commission to relax, for that LEC, any accounting rules necessitated only by the rate-of-return-based low-end adjustment mechanism. For all these reasons, we eliminate the low-end adjustment mechanism for price cap LECs obtaining pricing flexibility.

167. Any LEC obtaining Phase I regulatory relief in any MSA will be precluded from making any low-end adjustment throughout its entire, holding-company-wide, service region, regardless of whether it files separate tariffs for each of its study areas. Permitting MSA-by-MSA low-end adjustments would require the same kind of burdensome cost allocation rules that we describe above. Furthermore, eliminating the low-end adjustment will not result in confiscatory rates, because we will continue to permit price cap LECs to make above-cap tariff filings. We also conclude that an above-cap tariff investigation provides the best forum for determining whether the above-cap tariff would implicitly force the LEC's regulated ratepayers to bear some of the risk of the LEC's competitive ventures.[419]

168. We retain the low-end adjustment mechanism for price cap LECs that have not opted to exercise any Phase I or Phase II regulatory relief, however. As we note above, the flexibility we grant in Phase I and Phase II will exacerbate the efficiency-blunting effects of the low-end adjustment mechanism. By the same token, the inefficiencies associated with the low-end adjustment mechanism in the absence of these flexibilities are fairly minor. To be eligible for a low-end adjustment, a price cap LEC must earn less than a 10.25 percent rate of return, which would constitute a substantial earnings sacrifice for most price cap LECs. For those LECs, the benefits of the low-end adjustment mechanism would not justify such a sacrifice, because the mechanism permits only a one-time PCI adjustment to avoid back-to-back annual earnings below 10.25 percent. For this reason, we find that the benefits of retaining the low-end adjustment mechanism for those LECs that have not obtained Phase I or Phase II relief (ensuring that LECs' rates are not confiscatory without requiring above-cap filings) outweigh its effects on efficiency incentives.

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[418] The Commission retained the low-end adjustment mechanism to help prevent price cap regulation from becoming confiscatory. *Price Cap Fourth Report and Order*, 12 FCC Rcd at 16704. The above-cap filing is the only other mechanism in price cap regulation designed explicitly to prevent confiscatory rates. Any above-cap filing must be supported by the following: (1) cost support data broken down to the lowest possible level for each relevant basket for each of the most recent four years under price cap regulation; (2) a detailed explanation of the reasons for the prices of all rate elements to which the LEC does not assign costs; (3) a comprehensive explanation of how the carrier allocated costs among rate elements in the relevant basket; and (4) an explanation of the manner in which the LEC has allocated all costs, not just exogenous costs, among baskets. *LEC Price Cap Order*, 5 FCC Rcd at 6823.

[419] The Commission has stated that it would probably suspend any above-cap filing for the statutory five-month period. *Id.* at 6823-24.

3. Common Line Basket Issues

169. Above, we permit incumbent LECs to offer contract tariffs and volume and term discounts for access services once they satisfy the Phase I triggers. We also have designed our Phase I relief to limit headroom by requiring price cap LECs to remove the demand associated with contract tariff offerings from price caps, so that price cap LECs cannot use that pricing flexibility to raise access rates for those customers in the MSA that lack competitive alternatives. Phase I pricing flexibility for services in the common line basket does not raise the same concerns regarding headroom, because different price cap rules apply to the common line basket. There is no need to require price cap LECs to remove common line services offered pursuant to contract tariff from price caps, nor do we see any need for additional safeguards to prevent the creation of headroom as a result of volume and term discounts for services in the common line basket, because the current rules already preclude the creation of headroom in the common line basket. Specifically, Section 69.152(m) prohibits price cap carriers that choose to charge less than the maximum permitted end user common line charges (EUCLs) from making up any of that revenue through increases to other common line charges (primary interexchange carrier charges (PICCs) or carrier common line CCL) charges).[420] Similarly, Section 69.153 requires incumbent LECs to base their PICC calculations on the maximum revenues permitted under the rules, rather than the actual revenues recovered.[421] Thus, our rules do not permit a LEC to charge a higher PICC for some subscriber lines simply by reducing the PICC for other lines. Finally, Section 69.154 allows price cap LECs to impose CCL charges only to the extent that their permitted common line revenues exceed the maximum amount the LECs could have recovered through EUCLs and PICCs.[422]

E. Procedural Issues

1. Special Access and Dedicated Transport Services

170. *Background.* In the *Access Reform NPRM*, the Commission invited comment on the procedural requirements governing requests for pricing flexibility.[423] The Commission did not propose any specific pleading cycle, but it proposed establishing a deadline for Commission action of 90 days.[424]

[420] 47 C.F.R. § 69.152(m).

[421] 47 C.F.R. § 69.153.

[422] 47 C.F.R. § 69.154. Other restrictions also apply.

[423] *Access Reform NPRM*, 11 FCC Rcd at 21432, 21444.

[424] *Id.* at 21431.